

***United States Court of Appeals
for the Second Circuit***



APPELLEE'S BRIEF

77-1342

*To be argued on behalf of Appellees
Fields and Friedman by*

LOUIS BENDER and
SANDOR FRANKEL

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 77-1342

UNITED STATES OF AMERICA,

Appellant

—v.—

DOUGLAS P. FIELDS, FREDERICK M. FRIEDMAN, PE-
TER S. DAVIS, ALAN E. SANDBERG, and ERIC BERGE,
Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR APPELLEES FIELDS AND FRIEDMAN

BENDER & FRANKEL
*Attorneys for Appellees Fields and
Friedman*
225 Broadway
New York, New York 10007

LOUIS BENDER
SANDOR FRANKEL,
Of Counsel.

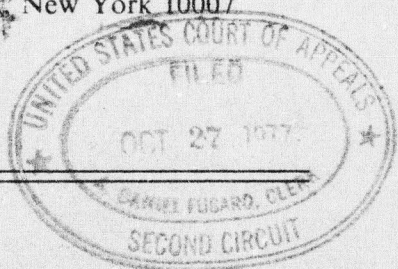


TABLE OF CONTENTS

	PAGE
QUESTIONS PRESENTED	1
COUNTER-STATEMENT OF PROCEDURE	1
COUNTER-STATEMENT OF FACTS	3
ARGUMENT:	
POINT I—Dismissal of portions of the indictment was proper because the indictment resulted directly from a breach by the SEC of the SEC's agreement with the appellees not to make a criminal reference of this case	4
POINT II—The District Court's dismissal of portions of the indictment based upon the SEC's improper and fraudulent conduct, even in the absence of an agreement between the SEC and the appellees, was a proper exercise of the District Court's supervisory power	23
A. The Terms of the Consent Decrees	24
B. The Remedy Proposed in the Government's Appellate Brief Should Be Rejected as a Matter of Both Procedure and Substance	33
(1) The Government's Waiver of Its Present Position	33
(2) The Inadequacy of the Government's Belated Suggested Remedy	35
C. The Propriety of the District Court's Remedy	36
POINT III—The District Court properly struck, on alternative grounds, portions of the indictment relating to the ERD transactions	49
POINT IV—The District Court properly dismissed Count 4 on alternative grounds	62
POINT V—Adoption of co-appellees' briefs	69
CONCLUSION	69

TABLE OF CASES

	PAGE
<i>Adler v. Klawans</i> , 267 F.2d 840 (2d Cir. 1959)	59
<i>Ash v. Brunswick Corp.</i> , 405 F. Supp. 234 (D. Del. 1975)	54
<i>Ballard v. Tingue Mills</i> , 128 F. Supp. 683 (D. Conn. 1954)	5
<i>Barnett v. Anaconda Co.</i> , 238 F. Supp. 766 (S.D.N.Y. 1965)	51
<i>Birnbaum v. Newport Steel Corp.</i> , 193 F.2d 461 (2d Cir. 1952)	51
<i>Brooks Towers Corp. v. Hunkin-Conkey Construction Co.</i> , 454 F.2d 1203 (10th Cir. 1972)	6
<i>Continental Bank & Trust Company of Salt Lake City v. Garfinkle</i> , 292 F. Supp. 709 (S.D.N.Y. 1968)	52
<i>Dandridge v. Williams</i> , 397 U.S. 471 (1970)	4
<i>Discon Corporation, In Re</i> , 346 F. Supp. 839 (S.D. Fla. 1971)	54
<i>Doe, Matter of</i> , 410 F. Supp. 1163 (E.D. Mich. 1976)	22
<i>Epic Enterprises, Inc. v. Brothers</i> , 395 F. Supp. 773 (N.D. Okla. 1975)	65, 66, 67
<i>Haberman v. Murchison</i> , 468 F.2d 1305 (2d Cir. 1972) .	51, 53
<i>Hellenic Lines Ltd. v. Gulf Oil Corp.</i> , 340 F.2d 398 (2d Cir. 1965)	5
<i>J. I. Case Co. v. Borak</i> , 377 U.S. 426 (1964)	63, 64
<i>Kern County Land Co. v. Occidental Petroleum Corp.</i> , 411 U.S. 582 (1973)	58, 59
<i>Landy v. FDI Corp.</i> , 486 F.2d 139 (3d Cir. 1973)	54
<i>Levy v. Johnson</i> , 1976-1977 CCH Fed. Sec. L. Rep. ¶95,899 (S.D.N.Y. Feb. 15, 1977)	63, 64, 65, 66, 67
<i>Lewis v. Elam</i> , CCH Fed. Sec. L. Rep. ¶96,013 (S.D.N.Y. 1977)	65, 67
<i>Limmer v. General Telephone & Electronics Corp.</i> , CCH Fed. Sec. L. Rep. ¶96,111 (S.D.N.Y. 1977)	65, 67
<i>Newburger, Loeb & Co. Inc. v. Gross, et al.</i> , Docket Nos. 76-7476, etc. (2d Cir. August 24, 1977), Slip Op. at 5492 (n. 25)	4

	PAGE
<i>Olmstead v. United States</i> , 277 U.S. 438 (1928).....	39
<i>Palermo v. Warden</i> , 545 F.2d 286 (2d Cir. 1976)	3
<i>Parsons v. Hornblower & Weeks</i> , 1976-1977 CCH Fed. Sec. L. Rep. ¶95,885 (M.D.N.C. 1977)	54
<i>People v. Santobello</i> , 39 App. Div. 2d 654, 331 N.Y.S.2d 776 (App. Div. 1st Dep't 1972)	22
<i>Robbins v. Banner Industries, Inc.</i> , 285 F. Supp. 758 (S.D.N.Y. 1966).....	65, 67
<i>Santobello v. New York</i> , 404 U.S. 257 (1971)	22
<i>Schlick v. Penn-Dixie Cement Corp.</i> , 507 F.2d 374 (2d Cir. 1974)	63, 64
<i>SEC v. Falstaff Brewing Corp.</i> , CCH Fed. Sec. L. Rep. ¶96117 (D.C.D.C. 1977)	56
<i>SEC v. Kalvex, Inc.</i> , 425 F. Supp. 310 (S.D.N.Y. 1975)	63, 65, 66
<i>SEC v. Parklane Hosiery Co., Inc.</i> , CCH Fed. Sec. L. Rep. ¶96,108 (2d Cir. 1977)	55, 56
<i>SEC v. Rapp</i> , 304 F.2d 786 (2d Cir. 1962)	56
<i>SEC v. Texas Gulf Sulphur</i> , 401 F.2d 833 (2d Cir. 1968)	60
<i>Sherman v. United States</i> , 356 U.S. 369 (1958)	37
<i>Smith v. Murchison</i> , 30 F. Supp. 1079 (S.D.N.Y. 1970). <i>Thomson v. United States</i> , 357 F.2d 683 (Ct. of Claims 1966)	51 5
<i>TSC Industries, Inc. v. Northway, Inc.</i> , 426 U.S. 438 (1976)	53
<i>United States v. Banks</i> , 383 F. Supp. 389 (D.C.S.D. 1974)	36
<i>United States v. Brasco</i> , 516 F.2d 816 (2d Cir. 1975)	50
<i>United States v. Braunig</i> , Docket No. 76-6716 (2d Cir. April 11, 1977)	34
<i>United States v. Carter</i> , 454 F.2d 426 (4th Cir. 1972)	18, 22, 37, 42
<i>United States v. DeMarco</i> , 401 F. Supp. 505 (C.D. Cal. 1975)	37
<i>United States v. DeMarco</i> , 407 F. Supp. 107 (C.D. Cal. 1975)	37
<i>United States v. DiStefano</i> , Docket Nos. 76-1581, etc. (2d Cir. May 16, 1977)	34

	PAGE
<i>United States v. Estepa</i> , 471 F.2d 1132 (2d Cir. 1972) ...	46
<i>United States v. Fuentes</i> , Docket Nos. 77-1083, etc., (2d Cir. Sept. 14, 1977), Slip Op. at 5890	34
<i>United States v. Hermann</i> , 524 F.2d 1103 (2d Cir. 1975)	34
<i>United States v. Jacobs</i> , 531 F.2d 87 (2d Cir. 1976), judgment vacated and case remanded for further consideration, U.S. , 97 S. Ct. 299 (1976), previous decision adhered to 547 F.2d 772 (2d Cir. 1976), cert. granted U.S. (May 31, 1977)	46
<i>United States v. Kurzer</i> , 534 F.2d 511 (2d Cir. 1976)	20
<i>United States v. Litton Systems, Inc.</i> (E.D. Va. May 25, 1977) (unreported decision reprinted in June 15, 1977 Congressional Record, p. E3793)	37
<i>United States v. Minnesota Mining and Manufacturing Company, et. al.</i> , 551 F.2d 1106 (8th Cir. 1977)	16, 17, 19, 20, 22, 42
<i>United States v. Orman</i> , 417 F. Supp. 1126 (D. Col. 1976)	37, 41, 42
<i>United States v. Pace</i> , No. 76 Cr. 501 (S.D.N.Y. December 17, 1976)	18
<i>United States v. Paiva</i> , 294 F. Supp. 742 (D.C.D.C. 1969)	18
<i>United States v. Payner</i> , 39 AFTR 2d 77-1433 (N.D. Ohio 1977)	41
<i>United States v. Phillips Petroleum Co.</i> , 40 AFTR 2d, 77-5301 (N.D. Okla. 1977)	18
<i>United States v. Quinn</i> , 445 F.2d 940 (2d Cir. 1971)	43
<i>United States v. Rand</i> , 308 F. Supp. 1231 (N.D. Ohio 1970)	37
<i>United States v. Rodman</i> , 519 F.2d 1058 (1st Cir. 1975)	15, 16, 19, 20, 21, 41
<i>United States v. Russell</i> , 411 U.S. 423 (1973)	22
<i>United States v. Schwartz</i> , 535 F.2d 160 (2d Cir. 1976)	34
<i>United States v. Stassi</i> , 544 F.2d 579 (2d Cir. 1975)	43

	PAGE
<i>United States v. Stofsky</i> , 527 F.2d 237 (2d Cir. 1975)	43
<i>Unites States v. Swarovski</i> , 557 F.2d 40 (2d Cir. 1977) ..	4
<i>United States v. Toscanino</i> , 500 F.2d 267 (2d Cir. 1974)	41
<i>United States v. Tweel</i> , 550 F.2d 297 (5th Cir. 1977)	41
<i>Walner v. Friedman</i> , 410 F. Supp. 29 (S.D.N.Y. 1975) ..	64, 65, 67
<i>Weiss v. Sunasco, Inc.</i> , 316 F. Supp. 1197 (E.D. Pa. 1970)	63
<i>Wessell v. Buhler</i> , 437 F.2d 279 (9th Cir. 1971)	54
<i>Whiting v. Dow Chemical Co.</i> , 523 F.2d 680 (2d Cir. 1975)	57, 58
<i>Willard Helburn, Inc. v. Spiewak</i> , 180 F.2d 480 (2d Cir. 1950)	5, 6
<i>Wolfson v. Solomon</i> , 54 F.R.D. 584 (S.D.N.Y. 1972)	54

STATUTES AND RULES CITED

United States Code	
Title 15	
Section 77q(a)	50
Section 77t(b)	42
Section 78n(a)	62
Section 78u(e)	42
Title 18	50
Section 371	50
Section 3282	50
Securities Act of 1933, Section 17(a)	50
17 C.F.R., Section 202.5(b)	42
SEC Regulation S-X, Article 4, 17 C.F.R. §210	65

OTHER AUTHORITIES CITED

SEC Release No. 5758 (November 2, 1976), Item 7(a) ..	68
SEC Release No. 34-13185 (January 19, 1977)	66, 67
Notes of the Advisory Committee on Rules referring to the Amendment to Rule 12(f) of the Federal Rules of Criminal Procedure (Public Law 96-64, §3(11), 89 Stat. 371, April 22, 1974, eff. December 1, 1975) ...	34

BRIEF FOR APPELLEES DOUGLAS P. FIELDS AND FREDERICK M. FRIEDMAN

QUESTIONS PRESENTED

1. Did the Government waive its right to make its present argument on the issue of remedy?
2. Did the SEC breach an agreement with the appellees not to make a criminal reference of this case?
3. Did the District Court abuse its discretion in dismissing portions of the indictment, under the particular circumstances of this case, where the SEC intentionally and fraudulently misled the targets it was investigating?
4. Was the District Court's dismissal of various portions of the indictment on alternative grounds proper?

COUNTER-STATEMENT OF PROCEDURE

By indictment filed November 8, 1976 appellees Fields and Friedman, with others, were charged¹ with various violations of the federal securities laws. Fields and Friedman filed pre-trial motions (which the other appellees adopted) seeking dismissal of the indictment and, alternatively, seeking dismissal of certain portions of the indictment. Among the grounds

¹ The Government repeatedly asserts that "defense counsel have freely conceded the culpability of defendants Fields, Friedman, and Davis" (GB 4-5, fn. ***; see also GB 5-6, GB 10, GB 22). Not only does this ignore the presumption of innocence, but the Government quotes out of context the testimony given at the hearing by counsel for the appellees in the civil proceeding and a statement of counsel for the appellees in the Court below. Counsel in the civil proceeding did not admit his clients were guilty, but advised the SEC of certain allegations that had been made and of certain of the underlying facts; and the fact that the Government has lifted out of context (at GB 5, fn.) the quotation of a statement of counsel for appellees in the Court below is perfectly obvious from the very next statement that the prosecutor made in the transcript on the very same page:

"Mr. Cutner: I haven't seen any admission of guilt here as to any of the charges." (Transcript 1127, lines 17-18) See also *infra*, p. 48, fn. 30.

raised in support of the motion to dismiss was the appellees' contention that certain events that occurred during the course of an investigation by the Securities and Exchange Commission ("SEC") into the matters that formed the basis of the indictment warranted dismissal. The Court held an extensive pre-trial hearing on this motion and, in a memorandum opinion and order dated June 2, 1977, granted the motion in substantial part; the Court also granted motions by Fields and Friedman to dismiss specific portions of the indictment on alternative grounds (A²³⁵, et seq.). The Government moved for rehearing and reconsideration and an order reinstating the dismissed portions of the indictment, and the Court, while granting the motion for rehearing and reconsideration, adhered to its original decision by memorandum opinion and order dated July 7, 1977 (A 121, et seq.). It is from these two orders that the Government now appeals.

It should be noted that the numerous suggestions in the Government's brief that the District Court acted precipitously and without due consideration³ are inaccurate. To the contrary, the District Court gave all parties a full and complete opportunity to present all relevant facts and to make any and all arguments. It conducted the hearing for a total of eleven days. Following the hearing, the District Court heard post-hearing arguments that lasted for another entire day, and permitted the submission of and considered voluminous post-hearing memoranda (in addition to voluminous pre-hearing memoranda previously submitted). Moreover, after rendering its decision and Order, the District Court did not, as the Government's brief states, "deny reargument" (GB⁴ 1); rather, the District Court

² The letter "A" followed by a number designates page reference to the joint appendix.

³ See, e.g., p. 16 of the Government's brief (alleging that the District Court "quickly" rejected a suggested remedy) and p. 25 of the Government's brief (the District Court gave "passing" consideration to the Government's proposed remedy).

⁴ The letters "GB" followed by a number designate page reference to the Government's brief on this appeal.

granted reargument to the Government, considered the Government's reargument on its merits (notwithstanding various technical objections raised by the appellees in addition to the appellees' substantive arguments), and, after considering all the matters raised by the Government on its motion, the District Court adhered to its original decision (A 121 et seq.).

COUNTER-STATEMENTS OF FACTS

The Government does not on this appeal seek to set aside any of the findings of fact of the District Court⁵. Notwithstanding this concession of the propriety of the District Court's findings, the "Statement Of Facts" set forth in the Government's brief omits highly relevant facts elicited during the hearing in the District Court and found by the District Court to be true, and misstates and distorts other facts. Therefore, appellees Fields and Friedman respectfully refer this Court to the District Court's findings of fact. They are contained in the District Court's memorandum opinion (which is reprinted in its entirety at A 35-A 120), and are specifically set forth therein at A 41-A 60. As the District Court's findings are succinctly stated there, they will not be restated herein. Rather, appellees respectfully refer the Court to those findings as the factual basis upon which this brief is based. Familiarity with those factual findings is hereinafter respectfully assumed.

⁵ "Appellate review of findings of fact is limited to a determination of whether those findings are 'clearly erroneous,' giving 'due regard . . . to the opportunity of the trial court to judge of the credibility of the witnesses.' . . . Where findings relate to the design, motive and intent behind human actions, they especially depend upon the credibility assessment of witnesses by those who see and hear them." *Palermo v. Warden*, 545 F.2d 286 (2d Cir. 1976) (U. S. App. Pndg.).

ARGUMENT

POINT I

Dismissal Of Portions Of The Indictment Was Proper Because The Indictment Resulted Directly From A Breach By The SEC of The SEC's Agreement With The Appellees Not To Make A Criminal Reference Of This Case.

The appellees in the Court below advanced two different grounds in support of their motion for dismissal of the indictment: (a) dismissal because of a breach by the SEC of its understanding with the appellees that the SEC would not make a criminal reference, and (b) even if there had not been such an understanding, dismissal under the Court's supervisory powers because of the SEC's fraudulent conduct. The appellees urged this first ground based upon the total course of conduct between the parties, including among other things the SEC's acquiescence by silence to the various statements made to the SEC's attorneys by the appellees' attorneys, and the SEC attorneys' affirmative misstatements. The District Court, while dismissing portions of the indictment on the second ground, rejected the appellees' first ground (the "agreement" ground). For reasons hereinafter set forth in Point II, *infra*, it is respectfully submitted that the ground upon which the District Court relied was wholly proper and appropriate, and that the Court's Order should be affirmed on that second ground. However, as this Court has recently observed, "the prevailing party may, of course, assert in a reviewing court any ground in support of his judgment, whether or not that ground was relied upon or even considered by the trial court." (*Newburger, Loeb & Co., Inc. v. Gross et al.*, Docket Nos. 76-7476, etc., (2d Cir. August 24, 1977), slip op. at 5492 (n.25), quoting *Dandridge v. Williams*, 397 U.S. 471, 475, n.6 (1970); see also *United States v. Swarovski*, 557 F. 2d 40, 49 (2d Cir. 1977). Accordingly, it is respectfully submitted that this Court may appropriately consider whether, based upon the undisputed findings of the District Court, an agreement was indeed reached between the

appellees and the SEC; if so, the District Court's dismissal of the relevant portions of the indictment should be sustained on that ground. It is respectfully submitted that based upon the District Court's underlying findings of fact, there was such an agreement.

It is well-established law that under certain circumstances silence by a party to whom an offer is made constitutes acceptance of and agreement with that offer. *Willard Helburn, Inc. v. Spiewak*, 180 F. 2d 480, 482-483 (2d Cir. 1950) ("In the absence of any explanation for their remaining silent, proof that they did so remain, knowing, or chargeable with knowledge, that the appellant was continuing to perform under the impression that the commission was satisfactory to them would create an estoppel which would have the same effect as their express assent to the terms stated in the letter. *Letta v. Cincinnati Iron & Steel Co.*, 6 Cir., 285 F. 707; *Allen-West Commission Co. v. Patillo*, 8 Cir., 90 F. 628."); *Hellenic Lines Ltd. v. Gulf Oil Corp.*, 340 F. 2d 398, 401 (2d Cir. 1965) (defendant's reply to plaintiff, "to the extent it failed to respond to [plaintiff's] assertions, under circumstances which reasonably called for a reply, could be found to constitute an admission by silence. *Willard Helburn Inc. v. Spiewak*, 180 F. 2d 480 (2d Cir. 1950); *Wieder v. Lorenz*, 164 Or. 10, 99 P. 2d 38 (1940)"); *Ballard v. Tingle Mills*, 128 F. Supp. 683, 688 (D. Conn. per Hincks, C.J. 1954) ("Silence and inaction in certain circumstances can operate as an acceptance of an offer, as, for instance, where the offeree with reasonable opportunity to reject offered services takes the benefit of them under circumstances which would indicate to a reasonable man that they were offered with the expectation of compensation. See Vol. 1, Restatement of the Law of Contracts, 372(b)."); *Thomson v. United States*, 357 F. 2d 683, 689, 690 (Court of Claims 1966) ("It is fundamental, however, that acceptance of an offer may be manifested either expressly (as by words) or impliedly by conduct indicating assent to a proposed bargain. Restatement 2d, Contracts §§ 5, 21, 21A, 52 (Comment c) (Tent. ed. 1, 1964); I Williston, Contracts, §§ 90, 91A (3d ed. 1957). . . . Where an offeree

knows or has reason to know that his conduct (viewed in the circumstances of the contract negotiations, including the purpose for which an agreement is sought) may reasonably and in good faith be seen as constituting assent to the terms of the offer, an acceptance may be implied."); *Brooks Towers Corp. v. Hunkin-Conkey Construction Co.*, 454 F. 2d 1203, 1207 (10th Cir. 1972) ("When the relations between the parties justify the offeror's expectation of a reply or where a duty exists to communicate either an acceptance or rejection, silence will be regarded as an acceptance. [citations omitted]").

The District Court, while recognizing this principle, held that it did not apply to this case—but that it was a close question. Thus, in making its determination, the District Court stated that in the case at bar, "the question [of whether there was such an agreement] is not free from difficulty" (A 65). However, the Court held that "on the question of silence, pure and simple, uncomplicated by any element of concealment, I conclude that defendants' reliance must be characterized as unreasonable." (A 65). Although the District Court did hold that "[i]n the case at bar, . . . more is presented than SEC silence in the face of defendants' expressed desire to avoid a criminal reference" (A 67)—including false statements by the SEC's attorneys to the defendants' attorneys and to others—and that "quite obviously, these facts give an additional dimension to the case" (A 67), the Court nevertheless held that these additional facts were insufficient to establish an agreement.

It is respectfully submitted, however, that the facts as found by the District Court were more than sufficient to establish that the SEC did in fact reach an agreement with the appellees that it would make no criminal reference of the case.⁶

⁶ The Government's brief repeatedly states that the appellees claimed the SEC attorneys had made them a "promise" of no criminal reference (see, e.g., GB 3, GB 13). The appellees' assertion was that under all the circumstances of this case they and their attorneys were led by the SEC's actions to believe, and did believe, that they and the SEC had an understanding, an agreement, that the SEC would not

The following are the relevant facts as found by the District Court with respect to this issue:

1. Whatever specific words were used by Gould at the initial meeting with the SEC's attorneys on January 14, 1975, Tucker⁷ (and presumably the other SEC attorneys present at the meeting who heard the same words) "was fully aware that defendants' counsel had as one of their two primary objectives [not merely "desires", as the Government asserts (GB 10)] the avoidance of a criminal reference." (F⁸16)

2. At his next meeting with the SEC, "Gould again made clear to the SEC representatives that one of his primary concerns was to avoid a criminal reference in respect of his individual clients (Fields, Friedman, and Davis)", a statement Gould again repeated during subsequent discussions with the SEC attorneys (F 19, F 24).

make a criminal reference of the case, and that under the circumstances that belief was reasonable. (Of course, the agreement at the outset was conditional upon stated circumstances being satisfied, i.e., a settlement being entered into that was satisfactory to the SEC and the SEC's satisfaction that the initial disclosures had been substantially complete. It was not disputed in the Court below that these conditions were in fact satisfied.)

⁷ It should be noted that Tucker and Perlmutter were not simply low-level functionaries in the SEC's New York Regional Office ("NYRO"). "Tucker, although reporting to his superiors at the New York regional office, was in operational command of the inquiry. Perlmutter was his top assistant." (See District Court's finding of fact #20). The line of command at the NYRO is as follows: regional administrator, two associate regional administrators, one of whom is assigned to enforcement, two assistant regional administrators under the associate regional administrator for enforcement, several branch chiefs under each assistant regional administrator, and staff attorneys, investigators, and accountants under the branch chiefs. During the course of the SEC's investigation Tucker became acting assistant regional administrator, and Perlmutter a branch chief. (A545-A547)

⁸ The letter "F" followed by a number designates reference to the District Court's numbered findings of fact.

3. "On June 17, 1975, in separate telephone conversations, Tucker advised Gould and Kantor that the SEC investigation was almost concluded; and that it appeared that the January 14 disclosures had been substantially complete and accurate." (F 21)

4. The minutes of the meeting of TDA's board of directors for July 18, 1975 state, *inter alia*:

"Mr. Kantor reported that on June 17, 1975, a member of the SEC staff had informed him that their investigation was 95 per cent complete and that his staff would not refer the matter for criminal prosecution." (A 401).

Fields and Friedman were present at this meeting and heard the statement. (A 475)

5. Fields and Friedman, in discussions with Gould relating to the settlement terms initially demanded by the SEC, resisted those terms, but were told by Gould "in response to their resistance that if Fields and Friedman did not authorize him to attempt to settle the case on the terms recommended by Gould, then the SEC would not be bound by the agreement which, in Gould's expressed view, it had made with them not to make a criminal reference." (F 25)

6. On September 16, 1975, the SEC filed its civil complaint. Gould believed this violated an agreement he had reached with Perlmutter that its filing would be deferred until the consent then being negotiated could be finalized and filed with the complaint. Gould angrily upbraided Perlmutter, and Perlmutter became "upset at the incident." (F 26)

7. Shortly after being upbraided by Gould, Perlmutter telephoned Assistant United States Attorney Sorkin "to urge that the United States Attorney's office 'investigate the TDA matter.' Perlmutter stated that 'we

really want to get TDA', but advised Sorkin that he first wanted to 'wrap up' the civil settlement before the United States Attorney began its own inquiry. Perlmutter made several other calls to Sorkin, of similar import, during October and November". (F 32)

8. On September 30, after Gould became ill and Judge Streit, his law partner, took over the representation of Fields, Friedman, and Davis, Judge Streit met with Tucker and Perlmutter. At this meeting the SEC attorneys announced that the money they would insist the appellees pay to TDA in order to settle the case was now \$585,000.00. "Judge Streit responded that it was a 'horrendous' amount, and there were serious questions concerning some of the figures, 'but in light of the fact that there is to be no criminal prosecution I shall endeavor to obtain the money for you' (Tr. 150-153)." (F 27)

9. "Tucker and Perlmutter remained silent in the face of [Judge] Streit's comment." (F 27)

10. "[Judge] Streit reported this meeting to Fields, Friedman and Davis, including the above-quoted statement that had been made by Judge Streit to which the SEC representatives had not responded." (F 28)

11. At subsequent meetings over the next several months among Fields, Friedman, Davis, and their attorneys, "Fields, Friedman and Davis resisted the terms that the SEC was demanding for settlement of the civil case. However, their resistance was overcome by their attorneys' advice to them that the SEC had agreed that if a satisfactory settlement was made of the civil action, there would be no criminal reference." (F 28)

12. After Gordon, attorney for Mosler, was told separately by Fields and by Kantor that as part of the settlement the SEC had agreed not to make a criminal reference, Gordon scheduled a meeting with Perlmutter for the specific purpose of confirming it. At that meeting,

"Gordon advised Perlmutter that he represented Mosler, and stated to Perlmutter, among other things, that in deciding whether to accept a directorship in TDA it was important for Mosler to know whether there was going to be a criminal reference of the case. Gordon further stated to Perlmutter that Gordon understood there was not going to be a criminal reference. Perlmutter assured Gordon that there was not going to be a criminal reference. Gordon thereafter reported Perlmutter's assurance to Mosler and to Fields." (F 29)

13. Tucker and Perlmutter falsely testified at the hearing that the conversation to which Gordon testified did not occur (A575, SA^{8a} 21). The Court expressly rejected their denials (F 29, A 68). (The Government states that the District Court found it "difficult" to make various findings of fact against Tucker and Perlmutter on issues of credibility (GB 4). This is inaccurate. The District Court's findings were clear and unequivocal. Indeed, with respect to the District Court's express rejection of the denials by Tucker and Perlmutter of Gordon's testimony regarding the substance of their meeting, the District Court expressly stated that Gordon's testimony was "evidence I have no hesitation in accepting." (A 68))

14. On October 20, when Ostrow, counsel for Sandberg, concluded he could not persuade Tucker and Perlmutter to pursue lightly, if at all, the complaint against Sandberg, "Ostrow agreed to recommend that Sandberg enter into a settlement, stating that settling would be 'better than going over to the golden dome', a reference to the United States Courthouse across the street from and visible from the window of the SEC's office. Ostrow's reference to 'going over to the golden dome' was intended by Ostrow to be a reference to facing a federal indictment. Under the circumstances, it was undoubtedly so understood by Tucker and Perlmutter, who chuckled at the statement but said nothing." (F 31)

^{8a} The letters "SA" followed by a number designates page reference to appellees' supplemental appendix.

15. On December 1, Gould and Judge Streit met with Tucker and Perlmutter to discuss the appellees' collateralization of their substantial financial obligations under the settlement then in its final stages, and Gould told them they had "got a great settlement, take it". That same afternoon, after Gould had left, Tucker referred the case to the United States Attorney's Office by means of a telephone conversation with Assistant United States Attorney Wing and a follow-up letter to Wing enclosing the SEC's pleadings in the case⁹. (F 33; A 205)

16. "At the time he made the criminal reference of the TDA case, Tucker knew that avoidance of a criminal reference was one of two primary objectives for Fields and Friedman in the civil settlement negotiations (the other being their retention as corporate officers), and the only objective for Davis, an attorney who was not an officer . . . Notwithstanding that knowledge, Tucker at no time disclosed to counsel for these defendants that a criminal reference had in fact been made. That non-disclosure was calculated and deliberate, not inadvertent. Tucker testified that he did not want to do anything that would jeopardize the civil settlement (Tr. 1028-1029); and that, in his view, the defendants:

" . . . believed that there would be no criminal case growing out of this and that is why they entered into a consent decree." (Tr. 1091)." (F 35)

Tucker similarly admitted on cross-examination:

"Q. Did it cross your mind that any of the lawyers for the defendants were suggesting to their clients that they favorably consider the terms of this consent decree because by doing so, they had a good chance of avoiding a criminal reference? Did that cross your mind?

⁹ This referral of the case violated the legal statutory and regulatory framework that has been established for the making of a criminal reference, as is more fully set forth in the brief being submitted on behalf of appellee Sandberg, the contents of which are respectfully incorporated herein by reference.

A. Yes.

Q. When? Did it cross your mind at about the time you got the consent decrees back signed?

A. I would imagine so, yes." (A634)

* * * * *

Q. Did you think that the issue of a criminal reference was material to the defendants and their attorneys?

A. The issue was definitely material.

Q. Did you know it to be material when you got back the consent decrees signed?

A. Yes." (A635)

* * * * *

Q. Didn't you perceive that he [Gould] still had as his objective and the defendants still had as their objectives after September 4, entering into a consent decree which as a matter of fact, would avoid a criminal reference?

A. Yes." (A636)

17. "[H]ad [Gould] known, subsequent to December 1 but before execution of the consents to judgment, that a criminal reference had in fact been made, he would have recommended to his clients that they not enter into the consents . . . Such advice would have been accepted, so that the SEC would have lost the civil settlement which Tucker's concealment of the criminal reference was specifically designed to protect." (F 37). Counsel for the other appellees would have similarly advised their clients, who would also have followed their advice. (F 38 and F 39).

18. From the above, it is clear that when Tucker thereafter received the consents duly executed by Fields, Friedman, Davis, Sandberg and Berge he was fully aware,

at the time of their receipt, that the appellees had signed the consents, and that their attorneys had so recommended, based upon their understanding that an agreement had been reached that if these consents were signed, the SEC would not make a criminal reference. Neither Tucker nor any other representative of the SEC had advised counsel for any defendant that the SEC was going to or had already criminally referred the matter to the United States Attorney's Office.

19. Although the District Court's opinion makes no reference to it, the following was also established. On May 5, 1976, Kantor first learned that the United States Attorney's Office was investigating the matters that had been set forth in the SEC's complaint. Kantor called Tucker and asked Tucker whether the SEC had made a criminal reference in violation of the SEC's agreement not to do so. Tucker replied that the SEC had not made a criminal reference. (A406-A408, A575-A576)

20. Based upon the foregoing, it was established that until and including the May 5, 1976 call from Kantor to Tucker, no SEC representative had ever told or indicated to any attorney for any appellee that Gould's proposal and stated objective on January 14, 1975, repeated thereafter, that the case be settled on a civil basis and that the SEC not make a criminal reference, was not accepted by the SEC. Gould, Judge Streit, Kantor, Fields, Friedman, Davis, Sandberg and Berge all acted throughout this period on the understanding that the SEC had agreed on January 14, 1975, subject to the contingencies previously discussed (and subsequently satisfied), that the SEC would not make a criminal reference; and Messrs. Tucker and Perlmutter were aware, during all stages of their involvement and participation in this case, that Gould, Judge Streit, Kantor, and the appellees were proceeding on the basis of that understanding.

21. Tucker and Perlmutter, in testifying during the hearing that Gould had been specifically told that there was "no deal on criminal", testified falsely. (F 24).

22. Accordingly, the District Court held that Tucker and Perlmutter "behaved improperly in this case" and engaged in a "deplorable" course of conduct of "misleading counsel" (A 70), and that "the SEC representatives in question engaged upon a deliberate course of concealment, first of their intention to make a criminal reference, and then of the fact that the reference had been made, in order to obtain civil consent judgments imposing substantial sanctions upon the defendants", and further observed, "It is a sad irony that representatives of a governmental agency dedicated to the prevention of fraudulent and misleading statements fell into this particular pattern of behavior." (A72)

Of course, appellees recognize the District Court's concern (which apparently formed the basis for its holding that there was no agreement under these circumstances) that "a holding that SEC staff attorneys, by silence alone, may place the Government in a position where no subsequent criminal charge can be made, has enormous potential for mischief." (A 66) However, as the District Court recognized, it was dealing with a specific factual situation applicable to this particular case: "The Court's holding is limited to the particular circumstances of the case, as revealed by the evidence." (A 70) Thus, the District Court rejected appellees' argument that the "informal" criminal reference system was *per se* improper (see accompanying brief of appellee Sandberg), and further expressly stated "I do not hold that SEC negotiators are obligated, in all circumstances, to keep defense counsel *au courant* as to their tentative or preliminary thoughts on a *future* criminal reference; or that equally preliminary conversations between the SEC and a United States Attorney must be promptly revealed." (A 72) However, in view of the particular circumstances of this case, it

is respectfully submitted that the above facts, all of which were specifically found by the District Court and none of which are disputed by the Government on this appeal, clearly established an agreement between the SEC and the appellees in this case that the SEC would not make a criminal reference of this case, and that the SEC, in referring the case to the United States Attorney's Office, breached that agreement.

The legal consequence of the SEC's breach of this agreement is clear: the indictment which resulted from the SEC's breach of this agreement should be dismissed. In this connection it should be noted that the Government conceded at the hearing that the case did in fact reach the United States Attorney's Office through one source only: the criminal reference by the SEC. The Government thus retreated from the suggestion it had advanced in its pre-hearing memorandum that the case "might have" reached the United States Attorney's Office through some other means.¹⁰

A strikingly similar situation was presented to the United States Court of Appeals for the First Circuit in *United States v. Rodman*, 519 F.2d 1058 (1st Cir. 1975). There, the Circuit Court affirmed the District Court's dismissal of an indictment charging violations of the securities laws, on the grounds that the SEC had failed to honor an agreement it had made with the defendant during the SEC's investigation of the case that the

¹⁰ The Government's reply memorandum in opposition to the defendants' various motions, submitted prior to the hearing, stated:

"[S]pecific performance' of the alleged SEC promise would not, in any event, imply dismissal of the Indictment since the alleged promise carried no assurance against criminal prosecution. . . .

"[I]n the instant case, even if the SEC had made and kept the alleged promise, the defendant's knew that there was no assurance against criminal prosecution. While avoiding a specific reference of the case by the SEC might have reduced the risk of prosecution, it clearly provided no guarantee against the matter coming to the attention of the United States Attorney's Office from the District Attorney's Office, the newspapers, advance sheets, or any one of a number of other possible sources." (A161-A162)

SEC would strongly recommend to the United States Attorney's Office that the defendant not be criminally prosecuted. The District Court, after conducting a hearing, found that the SEC had made such an agreement and had broken it by not making a recommendation against criminal prosecution. The Circuit Court held:

"In light of the failure of the SEC to comply with what the district court found to be its agreement, the district court's view that the unfairness to the appellee warranted dismissal of the indictment was not an abuse of the court's supervisory function. See *Mallory v. United States*, 354 U.S. 449 (1959); *McNabb v. United States*, 318 U.S. 332 (1943)." (519 F.2d at 1059-1060).

The instant case presents the same factual situation. Here, the SEC, as part of an overall disposition of allegedly criminal matters concerning the appellees, agreed not to refer the case to the United States Attorney's Office; in *Rodman*, the SEC made a similar agreement, that is, that it would recommend that the United States Attorney's Office not criminally prosecute. In both this and the *Rodman* cases, the SEC violated its understanding, and in both cases criminal prosecution resulted from this violation. Accordingly, it is respectfully submitted that the holdings of both the District Court and the Circuit Court in *Rodman*, ordering dismissal of the indictment, are equally applicable here.

Another similar situation was presented in *United States v. Minnesota Mining and Manufacturing Company, et al.*, 551 F.2d. 1106 (8th Cir. 1977) (the "3M" case). There, the defendants moved to dismiss the indictment based upon an alleged agreement they had made with the Government pursuant to which the Government would not prosecute them for the offenses charged therein. The defendants there contended that the Government (specifically, the Watergate Special Prosecution Force) had agreed that the defendants' plea of guilty to misdemeanor violations and voluntary disclosure of

illegal corporate campaign contributions would be fully dispositive of criminal offenses arising out of illegal corporate campaign contributions, and that the prosecution there involved for criminal tax offenses arising out of those contributions should therefore be dismissed. The Circuit Court, after interpreting the District Court's findings of fact as constituting a finding of an agreement between the defendants and the Government such as the defendants had alleged, held that the defendants were entitled to specific enforcement of the agreement, and therefore upheld the District Court's dismissal of the indictment.

The Circuit Court in *3M*, in upholding the District Court's dismissal of the indictment, specifically addressed the issue of whether dismissal was an appropriate remedy. The Circuit Court's holding that such a remedy was appropriate is especially relevant to this case. The Government in *3M* urged upon the United States Court of Appeals for the Eighth Circuit the same argument which the Government urged upon the District Court in this case and is presently urging upon this Court, that dismissal is allegedly not an appropriate remedy.¹¹ The Circuit Court summarized and expressly rejected the Government's position:

"Finally, the Government argues that the District Court imposed an inappropriate remedy by dismissing the indictment. It is contended that the alternative, and more acceptable, remedy is to permit *3M* and Helzer to withdraw their guilty pleas on the § 610 illegal campaign contribution charges and to plead anew. Also, it is argued that the court might order suppression of all inculpatory evidence secured from the *3M* official who relied on the agreement.

". . . . As we have indicated, the agreement between *3M* and the Government contained a promise that the

¹¹ As noted *infra*, pp. 33-35, the Government on this appeal has shifted its ground regarding what the appropriate remedy should be.

Government would forego future criminal prosecution of 3M and its officials for all matters arising out of the illegal political contribution scheme. This was not a traditional plea bargain arrangement in which the trial judge was a participant. Rather, it was a prosecutorial agreement, the inviolability of which rested completely in the province of the government prosecutors, who have the sole power and responsibility to institute criminal proceedings. *Cf. United States v. Hammerman*, 528 F.2d 326, 332 (4th Cir. 1975). The Government breached this promise by returning the present indictment against defendants. The remedy for the breach of this promise rests in the discretion of the trial court, see *Santobello v. New York*, 404 U.S. 257, 263, 92 S.Ct. 495, 30 L.Ed.2d 427 (1971), and under the circumstances of this case we cannot say that the remedy of dismissing the indictment was either undue or an abuse of discretion."

We respectfully submit that, similarly, the District Court's dismissal of the indictment in the case at bar was neither undue nor an abuse of discretion. See also *United States v. Phillips Petroleum Co.*, 40 App. 2d, 77-5301, 77-5314 (N.D. Okla. 1977) (dismissing portion of an indictment because "When the United States Government gives its word to or makes an agreement with one of its citizens, the Government must be held to that agreement and keep its promises."); *United States v. Carter*, 454 F.2d 426 (4th Cir. 1972), *cert. denied* 417 U.S. 933 (1974) (holding that defendant is entitled to specific performance of agreement not to prosecute, if made); *United States v. Paiva*, 294 F.Supp. 742, 747 (D.C.D.C. 1969) ("If, after having utilized its discretion to strike bargains with potential defendants, the Government seeks to avoid those arrangements by using the courts, its decision to do so will come under scrutiny. If it further appears that the defendant, to his prejudice, performed his part of the agreement while the Government did not, the indictment may be dismissed."); *United States v. Pace*, No. 76 Cr. 501 (S.D.N.Y. December 17,

1976) (conclusion by magistrate, on reference by District Judge with consent of parties, recommending dismissal of indictment where circumstances reasonably led defendant to understand he had been granted immunity.).

Indeed, the case for dismissal in the instant case is even stronger than was the case for dismissal in either *Rodman* or *3M*. In both of those cases, the District Courts' orders dismissing the indictments were upheld by the respective Courts of Appeals notwithstanding the fact that in both cases the defendants could have been placed in the same positions that they would have been in had the Government not breached its agreement. Thus, in *Rodman*, the prosecutor agreed, during the course of the pre-trial hearing on Rodman's motion to dismiss the indictment, not to use any of Rodman's statements:

"Mr. Beckler [the prosecutor in *Rodman*]. Your Honor, one thing I wanted to say with regard to the defendant Rodman, I am not planning to use any statements made by the Defendant Rodman in court either as to himself or as to the other defendants.

The Court. That is what you were going to think about this morning.

Mr. Beckler. That's right."

* * * *

"The Court. The motion to suppress is just blown away?

Mr. Berger [defense counsel]. That's right, because of the fact that the government has agreed not to use any of those statements.

The Court. You will be held to that.

Mr. Beckler [the prosecutor]. Yes, your Honor, I understand." (A163-A164)

Yet notwithstanding the fact that the prosecutor in *Rodman* agreed to place himself in precisely the same position as the Government here argues that it is in—i.e., that the defendant made no statements that the Government may use against him—both the District Court and the Circuit Court in *Rodman*

held that the indictment should be dismissed.¹² Similarly in *3M* the Government's suggested alternative remedy—a vacatur of the defendants' guilty pleas, and suppression of all inculpatory statements—would have placed the defendants in the same position they would have occupied had the Government not breached its agreement. In the instant case, dismissal was especially appropriate in view of the District Court's findings, amply supported by the record (and tacitly conceded by the Government—see p. 27, *infra*), and that no other remedy could have effectively placed the appellees in the position they would have been in but for the Government's misconduct. Indeed, even if an order could have been fashioned restoring the appellees to such a position, both *Rodman* and *3M* support the District Court's dismissal of the indictment as an appropriate exercise of the District Court's discretion under its supervisory powers.

The Government's assertion, repeatedly made (see, e.g., GB 4, GB 14, GB 29, GB 34), that dismissal was an inappropriate remedy because the appellees were not prejudiced "in the criminal case" should be considered in this context, and should be rejected for two reasons: (a) the defendants were prejudiced in the criminal case¹³, and (b) in any event a showing of prejudice "in the criminal case" is not a prerequisite

¹² The Government argues in its brief (at GB21, fn.) that suppression in *Rodman* "did not eliminate the possibility" of taint in *Rodman*. The answer to this, of course, is that District Courts regularly determine issues of taint. Cf. *United States v. Kurzer*, 534 F. 2d 511 (2d Cir. 1976). Indeed, the District Court in *Rodman*, in addition to its order dismissing the indictment, also alternatively suppressed Rodman's statements "in case some other court disagrees with me on the matter of the motion to dismiss." (A165) The Government's other attempted distinction of *Rodman*—that the SEC's "consent to suppression . . . did not eliminate the likelihood that" there would have been no prosecution if the SEC had fulfilled its agreement—leaves *Rodman* precisely parallel to this case, as in both cases if the SEC had lived up to its agreements there would have been no criminal cases.

¹³ They were also, of course, greatly prejudiced "outside" the criminal case—see pp. 24-33, *infra*.

to an exercise by the District Court of its discretion in dismissing an indictment.

In *Rodman*, the defendant was prejudiced "in the criminal case" by the Government's breach of its agreement with him in exactly the same sense—and it is a major sense—as the appellees in this case. The prejudice "in the criminal case" to the appellees in this case and in *Rodman* (in view of the Government's agreement to suppression of Rodman's statements) was this: had the Government lived up to its agreements in each of these cases, there would have been no criminal case. This case reached the United States Attorney's Office, and hence the grand jury, as a direct result of the SEC's breach of the understanding between the appellees and the SEC that the SEC would not make a criminal reference of the matter (notwithstanding the suggestion to the contrary initially made in the Government's memorandum in the Court below, discussed *supra*, page 15). In short, the clearest and most immediate prejudice suffered by the appellees "in the criminal case" as a result of the SEC's violation of its agreement with them is that the appellees were indicted as a direct fruit of the Government's breach of the agreement.¹⁴

Moreover, and beyond this demonstration of prejudice "in the criminal case", it is respectfully submitted that no such showing need be demonstrated to justify the District Court's dismissal of the indictment. The Government fails to cite a single judicial or other authority for the proposition that any prejudice of any type need be shown in order for the Government to be bound to its agreements and held to a standard of non-fraudulent dealing with the citizenry. This very argument by the Government was met and specifically rejected in *Matter*

¹⁴ The claim in the Government's brief (at GB 14 and GB 18, fn.*) that appellees in the Court below did not assert that they were prejudiced "in the criminal case" is, simply, wrong. See, e.g., Fields' and Friedman's "Reply Memorandum Of Law" in support of motion to dismiss indictment (at pp. 19-21 thereof); Fields' and Friedman's "Proposed Findings Of Fact And Conclusions Of Law" submitted at conclusion of hearing (at page 43 thereof).

of *Doe*, 410 F. Supp. 1163, 1165, 1166 (E.D. Mich. 1976), where the court held that "judicial integrity and the interests of justice" required the Court to specifically enforce a commitment by the Government, even where there is "no prejudice, apart from that suffered by the administration of justice".¹⁵ The Court therefore vacated an immunity order insofar as that order would have permitted the Government to question the defendant concerning a transaction which the Government had agreed not to question him about.¹⁶

In this connection, the Supreme Court's decision in *Santobello v. New York*, 404 U.S. 257 (1971) is significant. In *Santobello*, the Supreme Court specifically enforced an agreement between the defendant and the Government by vacating the defendant's sentence where the Government failed to honor its agreement concerning a sentencing recommendation to be made to the sentencing court. The Supreme Court rejected in the following language the Government's argument that the defendant was not prejudiced by the Government's breach:

"He [the sentencing Judge] stated that the prosecutor's recommendation did not influence him and we have no reason to doubt that. Nevertheless, we conclude that the interests of justice and appropriate recognition of the duties of the prosecution in relation to promises made in the negotiation of pleas of guilty will be best served by remanding the case to the state courts for further consideration." 404 U.S. at 262-263.

(On remand, the Appellate Division held that *Santobello* was entitled to specific enforcement of the agreement—see *People v.*

¹⁵ Cf. *United States v. Russell*, 411 U. S. 423, 431-432 (1973) ("[W]e may some day be presented with a situation in which the conduct of law enforcement agents is so outrageous that due process principles would absolutely bar the government from invoking judicial processes to obtain a conviction. . . .")

¹⁶ Although the *Doe* case was discussed by the appellees in their memoranda in the Court below, and by the District Court in its opinion, the Government's Brief in this Court fails to mention it. The same is true with respect to the *3M* case in the District Court and *Carter*, *supra*.

Santobello, 39 App. Div. 2d 654, 331 N.Y.S.2d 776 (App. Div. 1st Dept. 1972)).

The Government half-heartedly relies on *Santobello* (at GB 19-20, fn.***) because dismissal of the indictment was not one of the remedies considered by the Supreme Court in that case. The Government's argument, however, is far from the mark, because in *Santobello* the indictment did not result from a breach of the Government's promise, *only the guilty plea resulted* from the Government's breach. Accordingly, the Supreme Court vacated the fruit of the violation, which in that case was the guilty plea, not the indictment. It is respectfully submitted that the same standard is fully applicable here, and that the fruit of the violation was also properly dismissed—in this case, the indictment itself.

On the issue of prejudice, it should also be noted that the appellees' consents to the judgments in the civil action subjected them to severe sanctions—see *infra*, pp. 24-33.

POINT II

The District Court's Dismissal Of Portions Of The Indictment Based Upon The SEC's Improper And Fraudulent Conduct, Even In The Absence Of An Agreement Between The SEC And The Appellees, Was A Proper Exercise Of The District Court's Supervisory Power.

The Government asserts that notwithstanding its present concession of the propriety of the District Court's findings of fact, the remedy adopted by the District Court was improper, and repeatedly states that "the appropriate remedy would have been (and still is) an order setting aside, with prejudice, the defendants' obligations further to perform pursuant to the terms of the civil settlement reached between the SEC and the defendants." (GB 4; see also GB 18, GB 22, GB 24, GB 25, and GB 35).

It is respectfully submitted that the Government, which did not even remotely suggest at any time in the District Court the remedy which it now suggests, is precluded from arguing to this Court the appropriateness of its newly proposed remedy.

Moreover, it is respectfully submitted that even considered "on its merits" the Government's belatedly proposed "remedy" is a capricious and arbitrary suggestion based on the Government's tacit recognition that the only appropriate remedy in this case was dismissal. Finally, it is respectfully submitted that the remedy adopted by the District Court was a proper exercise of its supervisory powers.

At the outset, in order to consider the issue of remedy, it is necessary to consider the settlement terms which the Government obtained from the appellees in the consent decrees.

A. The Terms Of The Consent Decrees

The Government's brief states that "the consent judgments were not onerous" (GB 24). It is respectfully submitted that this statement is wholly fallacious and, moreover, that the Government's brief misstates the factual nature and consequences of the consent judgments.

At the outset it should be noted that the Government's brief asserts inconsistent positions: for if the appellees could not effectively defend against the SEC's complaint because of their "extremely weak litigating position" (GB 22), if "the defendants had no real ability to defend against the SEC complaint"¹⁷ (GB 23), and if the offenses for which they were being sued by the SEC were so egregious, it is most inconceivable, to say the least, that the SEC would have permitted the appellees to escape with inconsequential sanctions. Moreover, the Govern-

¹⁷ It is hardly clear that the Government's civil case was "overwhelming." The SEC felt its case was sufficiently weak that it felt compelled to grant practical "immunity" (civil and criminal) to two witnesses (Messrs. Weston and Kreisler). (A 119, n. 8) Moreover, even assuming the truth of the substantive allegations contained in the SEC's complaint, there would have been substantial issues both of intent and of remedy, including financial terms (see *infra*, p. 28), and, especially in view of the long passage of time since the events in question, substantial questions of the scope of appropriate ancillary relief. In short, the Government's statements that "the defendants could not have completely avoided liability in the civil case" (GB 26) and that the appellees had no "substantive defense" (GB 11) are a presumptuous attempt by the Government to arrogate unto itself the Court's role in deciding disputes.

Further, the Government's statement (at GB 11) that the

ment's present position that the civil sanctions were "not onerous" was contradicted by Tucker himself, who testified that with respect to every aspect of the relief sought by the SEC Complaint, the relief achieved by the SEC in the consent decrees was in all respects "superb" (A 601-A 611).

The District Court's opinion succinctly states (at A117-A118, n.2) the nature of the relief sought by the SEC in its complaint, and the relief obtained by the SEC in the consent judgments:

"The various consents provided for the following relief which the SEC had demanded in its complaint:

(a) The SEC's complaint sought broad injunctive relief against the seven defendants in the civil action; all of the defendants consented to the injunctive relief which the SEC had demanded;

(b) In connection with the ERD transactions, the SEC's complaint sought payment of \$435,000.00 by Fields, Friedman, and Davis to TDA, which was the total amount of the alleged profits derived by all parties (not merely Fields, Friedman, and Davis) to these transactions. In their consents, Fields, Friedman, and Davis agreed to pay that entire amount to TDA, and fully collateralized that amount, although the SEC's own investigation revealed that the total amount received by these defendants from the ERD transactions was only \$72,250.00, and the defendants were still subject to civil lawsuits from the original sellers of the securities involved in the ERD transactions;

appellees' counsel during the investigation "recognized that any testimony by the defendants might have had serious consequences in any future criminal proceedings" is erroneous, because (a) defendants' counsel believed (and reasonably so) that there would be no criminal proceedings, and (b) Gould testified that as of June 1975, if the SEC had requested that the appellees testify before the SEC, "I would probably have compounded my idiocy in this case by letting them go and testify." (A 355)

(c) In connection with the Eagle Roofing finder's fee, the SEC's complaint sought payment of \$100,000.00 by Fields and Friedman to TDA, which was the total amount of the allegedly unlawful finder's fee. In their consents, Fields and Friedman agreed to pay that entire amount, which they fully collateralized, although the SEC's own investigation revealed that \$18,000.00 of that amount had never been received by any of the defendants;

(d) In connection with the Trophies, Inc. finder's fee, the SEC's complaint sought payment of \$50,000.00 by Fields and Friedman to Westcalind, which was the total amount of the allegedly unlawful finder's fee. In their consents, Fields and Friedman agreed to pay that entire amount, which they fully collateralized, although the SEC's own investigation revealed that \$15,000.00 of that amount had never been received by any of the defendants;

(e) The SEC's complaint sought an order prohibiting Fields and Friedman and Berge from acting as either officer or director of TDA or Westcalind; the consent judgments prohibited Fields, Friedman and Berge for a two-year period from serving as directors of TDA or Westcalind; and, further, from serving as chief executive officer of either company for a two-year period. However, Fields was permitted to remain president, in which capacity he would be chief operating officer, and Friedman was permitted to retain his positions as well;

(f) The SEC complaint sought an order prohibiting Fields and Friedman from voting their shares of TDA and Westcalind stock for a "just and proper" period of time; Fields and Friedman consented to such a prohibition for a two-year period;

(g) The SEC complaint sought an order appointing a receiver for TDA and Westcalind; the consents implemented this request to the SEC's satisfaction by providing for the appointment of independent directors for TDA and

Westcalind, as well as Fields' and Friedman's resignations from both boards of directors and the appointment of new chief executive officers for both corporations;

(h) Defendant Davis consented to the most severe administrative sanction available to the SEC, a lifetime resignation from practice before the SEC, as a result of which Davis was forced to resign from the law firm he had built up, which specialized in SEC practice, and was forced to give up the practice of law;

(i) Defendant Sandberg consented in all respects to all relief which the SEC complaint had sought against him, as did defendant Berge."

None of these findings are questioned by the Government on this appeal; indeed, they were all testified to by Tucker. In light of these settlement terms, the District Court accurately concluded that "it is impossible, by reopening the civil consent judgments, to restore the individuals concerned to the positions in which they found themselves at the time of the nondisclosure of the criminal reference, in December of 1975, and the subsequent execution of the consent judgments." (A 74) They have been prevented for over one and one-half years from acting as directors of TDA and Westcalind, from serving as chief executive officers of TDA and Westcalind, and from voting their shares of TDA and Westcalind stock. They have also been deprived for this period of time of the use of substantial assets, as the full extent of their financial obligations have been fully collateralized during this entire period of time.¹⁸ Indeed, the Government's abandonment in this Court of the remedy it had urged upon the District Court (see *infra*, pp. 33-35) is a tacit concession that that proposed remedy was inadequate.¹⁹

¹⁸ In addition, appellee Davis has been forced to effectively give up the practice of law.

¹⁹ The Government takes issues (at GB 25, fn.) with the District Court's observation that vacating the consent judgments as the Government urged as a remedy in the District Court would involve

The Government's brief, in addressing the consent judgments, makes numerous erroneous statements with respect to their terms and their consequences:

(1) With respect to the financial terms of the consents, the Government states that Fields, Friedman and Davis agreed to "repay" to TDA and Westcalind "\$585,000 fraudulently obtained *by them*" (GB 11; emphasis added). Yet it was conceded by Tucker and found by the Court that (a) of the \$435,000 involved in the ERD transactions, the appellees were not even alleged to have received more than \$72,250, yet in settling the case civilly they agreed to assume an additional obligation on the ERD transactions (after applying credits totalling \$142,250—see GB 12) of an additional \$220,250 *which the Government conceded the appellees never received*; (b) of the \$100,000 involved in the so-called "Eagle Roofing kickback", the appellees agreed to pay to TDA that entire amount, which included \$18,000 *which the Government conceded the appellees never received*; and (c) of the \$50,000 involved in the so-called "Westcalind kickback", the appellees agreed to pay Westcalind that entire amount, which included \$15,000 *which the Government conceded the appellees never received*. Thus, the assertion in the Government's brief that the appellees agreed to pay "\$585,000 fraudulently obtained by them" is false, as the Government conceded that as to \$253,250 of that amount, the appellees did not and were never even alleged to have received it.

the "unappealing" prospect of requiring "TDA shareholders" to restore to appellees money which appellees were required to pay under the settlements; the Government asserts that TDA's "shareholders" will not suffer as the money was paid to the corporation rather than to its shareholders. This is obviously a distinction without a difference. Moreover, shareholders who were not time-barred from suing appellees as of the time the consent judgments were entered in February 1976 concerning several of the allegations at issue would now be barred by the statute of limitations. Thus the Government's newly proposed "remedy" would entail further prejudice to TDA's shareholders.

(2) The Government states, repeatedly, that Fields' and Friedman's "out-of-pocket monetary liability has been completely reimbursed by TDA in the form of salary increases, bonuses and a 'one time' retroactive 'cost of living' increase" (GB 24). In support of this assertion the Government sets forth (at GB 13, fn. *) the following schedule²⁰:

"Remuneration to Fields and Friedman from TDA and Westcalind has been as follows:

	Salary year ended 6/30/75	Salary year ended 6/30/76	"One time" retroactive "cost of living" increase	Bonus 6/30/76
Fields	\$144,480	\$171,770	\$36,860	\$25,000
Friedman	\$102,000	\$108,552	\$36,860	\$25,000

(These figures do not even reflect contributions to pension and profit sharing plans of \$39,200 in fiscal 1975 and \$41,000 in fiscal 1976 for each defendant.) (App. 168-173)." (G.B. 13, fn*)

This schedule is misleading in the following respects:

(a) It is significant that of the four columns in the Government's schedule, all set forth the fiscal year involved except for the third column—which states only "'One time' retroactive 'cost of living' increase", without stating the year involved. This column appears between two columns relating to fiscal year ending June 30, 1976. The implication of the Government's presentation of these figures in column 3 is that

²⁰ The figures set forth in the Government's schedule are based upon excerpts from Forms 10-K for these two years, which the Government introduced into evidence. These excerpts are reprinted in the Joint Appendix at A 168-A 173. Because these pages are illegible in the Joint Appendix, they have been reprinted in appellees' Supplemental Appendix, at pp. SA 8-SA 15 thereof.

column 3 also applies to fiscal year ending June 30, 1976, an implication explicitly stated later in the Government's brief (see GB 24). If that were true, the increase in Fields' and Friedman's total compensation for fiscal year ended June 30, 1976 over fiscal year ended June 30, 1975 would be as follows:

	Compensation for fiscal year ended June 30, 1975	Compensation for fiscal year ended June 30, 1976
Fields.....	\$144,480	\$233,630
Friedman	\$102,000	\$170,412

Thus, the Government implies that Fields received for fiscal year ended 1976 a total increase over fiscal year ended 1975 of \$89,150, and that Friedman received a total increase over that period of \$68,412; and the Government suggests that this increase was a means by which Fields' and Friedman's financial liabilities under the settlement were effectively erased. However, what the Government's above-quoted schedule does not reflect is that the third column of its schedule—"One time retroactive cost of living increase"—applies not to fiscal year ended June 30, 1976, but to the three-year period ending June 30, 1975²¹. Therefore, the true comparison of Fields' and Friedman's total compensation for the two years according to the Forms 10-K is as follows:

	Compensation for fiscal year ended June 30, 1975	Compensation for fiscal year ended June 30, 1976
Fields.....	\$181,340	\$196,770
Friedman	\$138,860	\$133,552

²¹ (SA 10) It should be noted that as of June 30, 1975, according to the testimony of the SEC's attorneys, no settlement discussions had even commenced (A568).

Thus, Fields received for fiscal year ended 1976 an increase in total compensation over the previous year of only \$15,430 rather than of \$89,150; and Friedman received for fiscal year ended 1976 a *decrease* in total compensation from the previous year of \$5,308, rather than an increase of \$68,412.

(b) Moreover, even if the Government's figures were accurate, they would not establish the inference that the Government seeks to draw. First of all, the Government failed to introduce a shred of evidence that the salaries of either Fields or Friedman, or their "bonuses" or "cost of living increases", were based on any consideration of the SEC action, or on consideration of anything other than merit. There was no evidence of their contractual arrangements with their employers, nor was there any evidence of their performance as executives of the corporations, considered either in isolation or vis-a-vis the rest of the industry. As the District Court observed in ruling on the admissibility of the exhibits (which were first excluded but then, on the Government's persistent urging, admitted) "Maybe the Company was booming and he earned every cent of it." (SA 22) What was established, however, was that Fields and Friedman were the lifeblood of TDA and Westcalind (A 573). In short, the Government failed to introduce any evidence whatsoever that the compensation paid to Fields and Friedman, in any year, was based to the slightest extent on their financial obligations under the consent decrees. Indeed, the Government's brief does not mention that other officers of TDA and Westcalind who were completely unconnected with this case received identical bonuses (SA 14). Moreover, the fact remains that Fields and Friedman did assume these large financial obligations under their consent decrees, and if they were in a position to obtain

additional moneys from the corporations with those obligations, they could have obtained the same moneys without those obligations. Finally, and of great significance is the fact that as of June 30, 1976 and as of the date the bonuses were awarded for fiscal year ended June 30, 1976, TDA's and Westcalind's boards of directors—without Fields and Friedman—had been approved by the SEC.

(3) The Government states that the two-year prohibition of Fields' and Friedman's right to serve as directors of either TDA or Westcalind was inconsequential to them (GB 13). The sole reason advanced for this assertion—the amount of their compensation as officers—has been previously discussed. Moreover, the consent decrees prohibited Fields and Friedman from acting as directors either “directly or indirectly”, thus relegating Fields and Friedman during this period to passive positions on all non-operational matters affecting the corporations (it should be noted that it is undisputed that the appellees have complied in all respects with the consent decrees (A 632, A 498)). Finally, it is difficult to understand why the SEC insisted so vigorously on prohibiting Fields and Friedman from serving as directors (A 460) if this sanction was, as the Government now asserts, so meaningless.

(4) The Government states that Fields and Friedman were not prejudiced by the two-year prohibition on their right to vote their shares of TDA stock because the stockholders have not been asked to vote on any subject during the period of suspension. However, this is a bootstrap argument. The consent decrees provided that the additional directors to be appointed to the boards of TDA and Westcalind were to be selected only by consultation with the SEC and that they would be subject to Court approval. The most common matter for a stockholder vote was thereby effectively removed from the stockholders by the very consent decrees that the SEC insisted on. Furthermore, over the lengthy period of time

which the process of selection and approval of directors consumed, major matters for stockholder action such as major corporate mergers or acquisitions would have been impractical if not impossible for much of this period of time because of the state of uncertainty and flux arising out of the appointments of new directors under the consent decrees.

B. The Remedy Proposed In the Government's Appellate Brief Should Be Rejected As A Matter Of Both Procedure And Substance.

(1) The Government's Waiver Of Its Present Position

The District Court heard extensive arguments, and considered extensive memoranda, on the issue of the appropriate remedy in the event it accepted—as it eventually did—the facts alleged by the appellees. All parties, including the Government, were afforded an unlimited opportunity to be heard, before, during, and after the hearing.

Yet at no time prior to its brief as appellant in this Court did the Government suggest the remedy it now suggests. Rather, the Government, and the Director of the SEC's Division of Enforcement in Washington, D.C., Stanley Sporkin, Esq., who testified as a witness in this case, urged that there was only one remedy which the District Court should properly adopt in the event it found that the SEC behaved improperly in this case: vacatur of the consent judgments²². At no time did the

²² Indeed even as late as on its motion for reconsideration after the District Court's decision was rendered, the Government suggested—and then only conditionally—a “vacatur” of the consent judgments. (The Government now states that “the SEC consented to vacatur of the judgments. (App. 128)” (GB 4, fn.**)) This is inaccurate. Rather, in an affidavit by the prosecutor in support of the Government's motion for reargument, the prosecutor stated, for the first time, “I have been authorized by the Commission for the purpose of this [motion for] rehearing to represent that, on the basis of the factual findings contained in this Court's opinion dated June 2, 1977, should the Court determine that the appropriate alternative remedy in the case would be directed towards the civil relief obtained by the

Government even suggest what it now suggests as a remedy: vacating with prejudice the portions of the civil settlements which the Government states the appellees have not yet performed. Thus, the answer to the rhetorical question which the Government's brief (at GB 25) disingenuously asks—why did the Court fail to consider as a remedy modifying the consent decrees as the Government now suggests rather than vacating those decrees—is clear: *because the Government did not at any time or in any manner suggest such a remedy*. Accordingly, it is respectfully submitted that the Government is now precluded from advancing in this Court its so-called "alternative remedy".

"As we recently reiterated where a party has shifted his position on appeal and advances arguments available but not pressed below . . . , and where that party had ample opportunity to make the point in the trial court in a timely manner, . . . waiver will bar raising the issue on appeal." *United States v. Fuentes*, Docket Nos. 77-1083 etc., (2d Cir. Sept. 14, 1977), Slip Op. at 5890, quoting from this Court's opinion in *United States v. Braunig*, Docket No. 76-6716 (2d Cir. April 11, 1977), *cert. denied* 45 U.S.L.W. 3790 (June 1977).

To the same effect, see *United States v. DiStefano*, Docket Nos. 76-1581 etc., (2d Cir., May 16, 1977), Slip op. at 3548, n. 5; *United States v. Hermann*, 524 F.2d 1103 (2d Cir. 1975); *United States v. Schwartz*, 535 F.2d 160, 163 (2d Cir. 1976) *cert. den.* U.S. ; see also Notes of the Advisory Committee on Rules referring to the Amendment to Rule 12(f) of the Federal Rules of Criminal Procedure (Public

Commission in the matter of *SEC v. TDA Industries, Inc., et al.*, then the Commission is prepared to seek to vacate the injunction and ancillary relief obtained therein." (A 128) The Government was in effect attempting to bargain with the Court by conditioning its "preparedness" to reopen the consents. The Government's similar attempt at bargaining with the Court, in connection with the SEC's alleged internal investigation of its attorneys' misconduct, is discussed *infra*, pp. 44-46.)

Law 96-64, § 3(11), 89 Stat. 371, April 22, 1974, eff. December 1, 1975), stating:

"The amendment makes clear that the defendant and, where appropriate, the Government have an obligation to raise the issue at our motion date set by the judge pursuant to subd. (c)."

(2) *The Inadequacy of The Government's Belated Suggested Remedy*

Even if the Government's belatedly suggested alternative is considered on its merits, it is respectfully submitted that it should be rejected for several reasons.

In the first place, it is completely arbitrary. The Government suggests no reason, and we can perceive none, as to why relieving the appellees from further compliance with the judgments would restore the appellees, as the Government now concedes they should be restored, to the position they would have been in absent the SEC's misconduct. Thus, for example, if this Court were to order such a remedy from the bench right after oral argument the appellees would be in a different position than if, for example, this Court were to order such a remedy in four or six months, or if the District Court were to have ordered such a remedy *sua sponte* at the conclusion of the hearing in May. Such an arbitrary suggestion hardly comports with the notion of a rational remedy.²³

Moreover, it should be noted that 100% of the appellees' financial obligations were required to be, and have at all required times been, fully collateralized under the consent decrees. They have therefore been stripped of assets to the full extent of their total obligations during this period of time. Indeed, appellee Friedman had to borrow collateral in order to satisfy the collateralization requirements (A 491).

²³ Indeed, the arbitrariness of the Government's newly proposed remedy is highlighted by the assertion in the Government's brief (at GB 24) that "the civil settlement would have been much the same regardless of" nondisclosure by the SEC of the criminal reference.

Finally, the appellees respectfully wish to advise the Court of the following. Because the Government never suggested its present proposed "remedy" to the District Court, no record was ever developed of the extent to which the appellees have complied with the judgments, except that they have in fact complied. However, the monetary sanctions imposed by the judgments required the appellees to pay certain sums of money *by* stated dates, not *on* certain dates (A157). The Government repeatedly asserts that its proposed remedy would clearly alleviate the financial sanctions imposed against Fields and Friedman (GB 12-13, GB 24-25). We wish respectfully to advise the Court that in June, 1977 prior to the Government's having filed its notice of appeal in this action and prior to any indication that the Government would suggest its new remedy on appeal if an appeal were to be taken, appellee Fields paid his entire remaining obligation. Documentary evidence to that effect, including bank debit and credit notices, is reproduced at SA5-SA7. Thus, the Government's newly proposed remedy is not only inadequate but also completely inapplicable in Fields' case.

C. The Propriety of The District Court's Remedy

It is respectfully submitted that dismissal under the facts of this case, whether because of an "agreement" entered into by the SEC or because of the SEC attorneys' fraudulent misconduct, was an appropriate exercise of the District Court's discretion. Whether the SEC's action is labeled a breach of an agreement or a stratagem of deceit is not a difference of substance. It is respectfully submitted that the Government's perpetration of fraud and deceit upon a party with whom it is dealing is as egregious as the Government's breach of an "agreement" that has been made.

Thus, even in the absence of an agreement, other courts have similarly dismissed indictments as a result of misconduct by the Government. See, e.g., *United States v. Banks*, 383

F.Supp 389, 392 (D.C.S.D. 1974), app. dismiss'd 513 F.2d 1329 (8th Cir. 1975) ("This Court has supervisory powers over the administration of justice. . . . The remedy should be directly related to the seriousness of the misconduct, *i.e.*, serious misconduct warrants a more drastic remedy than does minor misconduct. . . . I feel that the interests of justice are best served by dismissal."); *United States v. Rand*, 308 F.Supp. 1231, 1234 (N.D. Ohio 1970) (where the Court described the Government's misconduct as "not villainy, but misguided stratagems" but nevertheless found the Government's conduct to be unconscionable and therefore dismissed the indictment); *United States v. DeMarco*, 401 F.Supp. 505 (C.D. Cal. 1975), aff'd 550 F.2d 1224 (9th Cir. 1977); *United States v. DeMarco*, 407 F.Supp. 107 (C.D. Cal. 1975); *United States v. Orman*, 417 F.Supp. 1126 (D.Col. 1976); *United States v. Litton Systems, Inc.*, (E.D. Va. May 25, 1977) (unreported decision reprinted in June 15, 1977 Congressional Record, p. E3793, remarks of Hon. Joshua Eilberg); Cf. *Sherman v. United States*, 356 U.S. 369, 380 (1958) (Frankfurter, J. concurring) ("Insofar as they are used as instrumentalities in the administration of criminal justice, the federal courts have an obligation to set their face against enforcement of the law by lawless means or means that violate rationally vindicated standards of justice, and to refuse to sustain such methods by effectuating them. . . . Public confidence in the fair and honorable administration of justice, upon which ultimately depends the rule of law, is the transcending value at stake.")

The elements of the Government's fraud and deceit are set forth *supra*, pp. 7-14, and will not be repeated here. Suffice it to say that the SEC's attorneys deliberately misled defense counsel (and thereby the appellees) with whom they were dealing. The extent of the fraud can perhaps be most graphically illustrated by placing in proper time sequence several of the SEC attorneys' more outrageous acts. Right after Gould upbraided Perlmutter for filing the SEC complaint before the consents had been fully negotiated, Perlmutter called the

United States Attorney's Office to urge it to investigate the TDA matter, but not to do so until the civil settlements were "wrapped up". Perlmutter obviously considered that there was some connection between "wrapping up" the settlements and the appellees' belief that they would not be criminally prosecuted. Perlmutter made several other calls of similar import to the United States Attorney's Office over the next several months. During this same period of time, attorney Gordon met with Perlmutter to verify Fields' and attorney Kantor's statements to Gordon that the SEC had agreed that it would not make a criminal reference of the case. Gordon fully advised Perlmutter of the importance of the issue to Gordon: Gordon's client, a substantial businessman, was considering becoming a director on TDA's reconstituted board of directors, but would not do so unless he knew there would not be a criminal reference. Perlmutter assured Gordon that there would be no criminal reference—this during the same period of time when Perlmutter was urging the United States Attorney's Office to take the case (but only after the civil settlements were "wrapped up"), telling the United States Attorney's Office about the "great case" against TDA and stating that "we really want to get TDA". Thus, Perlmutter on the one hand was telling Gordon and, through Gordon, Gordon's original sources of information (Fields and Kantor), that there would be no criminal reference, while Perlmutter was simultaneously urging the case upon the United States Attorney's Office. In addition, none of the SEC attorneys, who concededly knew that the objective of the appellees and their counsel in entering into these onerous settlements with the SEC was the avoidance of a criminal reference, advised any of the defense attorneys that there would be, or had been, or might be, a criminal reference; rather, they knowingly and wilfully participated in a course of conduct in which they deliberately withheld and concealed from the appellees what they realized was to the appellees' the most important fact in all of the negotiations, notwithstanding the SEC attorneys' full knowledge and awareness that the appellees and their attorneys were agreeing to the civil settle-

ment—as Judge Streit stated to Tucker and Perlmutter on September 30, 1975—“in light of the fact that there is to be no criminal prosecution.” (F 27) The SEC attorneys’ actions were, as the District Court found, “calculated and deliberate, not inadvertent”, and were continued even in the face of Judge Streit’s and Ostrow’s expressed belief that by entering into the civil settlements they were avoiding a criminal reference. And the reason for the SEC attorneys’ misconduct was simply that they did not want to do anything that would jeopardize the civil settlements. In light of the facts of this case, the District Court’s comment that “It is a sad irony that representatives of a governmental agency dedicated to the prevention of fraudulent and misleading statements fell into this particular pattern of behavior” (A 72) was most appropriate. Indeed, if the SEC were ever to be the recipient of a filing which deliberately concealed information of comparable materiality, the likelihood is that the SEC would not only deem such conduct fraudulent, but criminal.

In addressing instances of governmental misconduct, it is pertinent to recall (as the District Court did at A 76) the oft-quoted observation of Mr. Justice Holmes, dissenting in *Olmstead v. United States*, 277 U.S. 438, 470 (1928):

“[F]or my part, I think it a less evil that some criminals should escape than that the Government should play an ignoble part.”

The Government argues that the District Court’s remedy was inappropriate on the following grounds: (a) the remedy allegedly goes beyond merely placing the appellees in the position they would have been in the absence of the Government’s misconduct (GB 19-27), (b) the SEC and not the United States Attorney’s Office was the culpable party (GB 28-31), (c) the SEC’s conduct was an isolated instance whose repetition the SEC has itself taken steps to prevent (GB 31-32), and (d) the appellees are not entitled to equitable relief because of their “unclean hands” (GB 32-33). For the follow-

ing reasons, it is respectfully submitted that all of these arguments by the Government should be rejected.

(a) *The "Remedial" Nature Of The Sanction*

The onerous nature of the settlements to which the appellees consented, and the impossibility of restoring the appellees to the position they would have been in had the Government not engaged in its wrongful conduct, have been previously discussed (*supra*, pp. 24-33) and will not be repeated here, except to note that the remedy suggested by the Government in the District Court—vacatur of the consent judgments—would not "make the defendants whole" (as the Government tacitly admits by no longer suggesting that remedy in this Court), and neither would the new remedy now belatedly suggested by the Government in this Court. Under the facts of this case, the only "remedial" remedy available was for the District Court to dismiss the indictment.

(b) *The SEC's, And Not The United States Attorney's Office's, Culpability*

The fact that the District Court found that the United States Attorney's Office was blameless²⁴ and that the SEC was at fault does not render the District Court's dismissal of the indictment an abuse of discretion. To the contrary, that dismissal was entirely appropriate in view of the nature and extent of the SEC's misconduct. As the District Court rightly held:

"It is Government, in all its offices and functions, which must be held to standards of fair and honest dealings with the citizens of the Republic." (A 82)

²⁴ Whether or not the United States Attorney's Office was "blameless", it was at the least made an unwitting ally in the SEC's misconduct, as the Assistant United States Attorney whom Perlmutter urged to take the "great case" against TDA but to wait until the civil settlements were "wrapped up" did in fact follow the latter request.

This principle has been applied by other courts confronted with similar acts of misconduct by agents of the Government other than the prosecuting authority in the cases there involved. In this respect *United States v. Rodman*, *supra*, is exactly in point. In *Rodman*, as in the instant case, the misconduct at issue was committed by the same agency involved in this case—the SEC—and not by the United States Attorney's Office. Notwithstanding this fact which the Government now argues is so significant, the Circuit Court in *Rodman* dismissed the indictment. The applicability of *Rodman* to the instant case in this respect is highlighted by the fact that although the Government's brief (at GB 29, fn. *) states that *Rodman* (and three other cases) is "easily distinguishable from the present case", the Government there²⁵ fails even to suggest a single such distinction.²⁶

²⁵ The Government elsewhere (at GB 21, fn.) attempts to distinguish *Rodman* in other respects, all of which for reasons set forth *supra*, pp. 15-21, are inadequate.

²⁶ Instead the Government attempts to distinguish only the three other cases, but fails, as noted, to distinguish *Rodman* from the instant case on this issue. Moreover, the Government's purported distinctions of those other cases are inapposite. The Government states (at GB 29-30, fn. *) that *United States v. Tweel*, 550 F.2d 297 (5th Cir. 1977), and *United States v. Payner*, 39 AFTR 2d 77-1433 (N.D. Ohio 1977) (*United States v. Orman*, 417 F.Supp. 1126 (D. Col. 1976) is discussed *infra*, p. 42) are distinguishable from the instant case because both involved suppression of evidence rather than dismissal of the indictment. However, it should be noted, first, that the District Judge stated his awareness of that fact in his opinion in this case. (A 82). Moreover, as this Court noted in *United States v. Toscanino*, 500 F.2d 267, 276 (2d Cir. 1974), "the supervisory power is not limited to the admission or exclusion of evidence, but may be exercised in any manner necessary to remedy abuses of a district court's process." Furthermore, in neither *Tweel* nor *Payner* did the defendant move for dismissal of the indictment, but only for suppression of evidence, and thus the issue of whether dismissal was an appropriate remedy was never before those courts. Finally, in both *Tweel* and *Payner* the prejudice suffered by the defendants was merely of an evidentiary nature—i.e., their only "prejudice" resulting from the Government's misconduct was that the Government obtained evidence it would not have otherwise obtained; in the instant case, however, the appellees' prejudice was far greater, as their indictment resulted from the SEC's breach of the agreement, and they were subjected, moreover, to severe sanctions under the civil settlements which resulted from the SEC's misconduct.

The Government's attempt (at GB 30, fn.), to totally divorce the SEC's activities in a criminal securities case from those of the United States Attorney's Office strays far from reality. The SEC has express statutory authority to forward cases to the United States Attorney's Office for criminal prosecution. 15 U.S.C. §§ 77t(b), 78u(e); 17 C.F.R. § 202.5(b). The SEC did in fact forward this case to the United States Attorney's Office (albeit outside the legally prescribed procedure for doing so). Moreover, it is respectfully submitted that this Court may judicially notice the practice of joint participation by SEC attorneys at trial with representatives of the United States Attorney's Office in criminal cases developed by the SEC.

Other courts have similarly dismissed indictments notwithstanding the fact of the "blamelessness" of the prosecutors there involved. In *United States v. Orman*, 417 F.Supp. 1126 (D.Col. 1976), the Government similarly attempted to disavow misconduct of the Government (in that case agents of the Drug Enforcement Administration), and the District Court held:

"[A]lthough government counsel has disavowed the conduct of 'the enforcement officials (who) are agents of the prosecuting party,' I think that the clear invitation of *Thomas* [*United States v. Thomas*, 474 F. 2d 110 (10th Cir. 1973)] is to deal with the matter by ordering dismissal of the indictment." (417 F.Supp. at 1138)

See also, e.g., *3M*, *supra* (the prosecuting office in *3M* was uninvolved in the agreement there at issue); *United States v. Carter*, *supra* at 428 (where a different United States Attorney's Office from the one handling the case had reached an alleged "understanding" with the defendant, and the Circuit Court held that "the United States Government is the United States Government throughout all the states and districts . . . There is more at stake than just the liberty of this defendant. At stake is the honor of the Government, public confidence in the fair administration of justice, and the essential administration of justice in a federal scheme of government.")

The Government cites three cases (at GB 29) where it claims this Court declined to "impute responsibility" to the prosecuting agency for alleged misconduct of other Government officials. Notwithstanding the Government's phrase, it is respectfully submitted that the issue is not whether "responsibility" is to be "imputed" to the prosecuting office, but whether under the totality of circumstances in this particular case the misconduct by the SEC (whether through breach of an agreement or through fraud) justified the order of the District Court, in the exercise of its discretion and under its supervisory powers, dismissing the indictment.

Moreover, each of this Court's three cases upon which the Government relies was wholly distinguishable from the case at bar. Thus, in *United States v. Stassi*, 544 F.2d 579 (2d Cir. 1975), *cert. den.* ——— U.S. ———, the "misconduct" at issue was gross negligence, rather than fraud as in the instant case, and the negligent agency was the Parole Board, whose differences from the SEC are self-evident. In *United States v. Stofsky*, 527 F.2d 237 (2d Cir. 1975) not only was there no fraud on the part of the Government agency involved, in that case the IRS²⁷, there was not even any negligence, as this Court rejected the proposition that knowledge of all information on file at the IRS must be imputed to the Government. Similarly, in *United States v. Quinn*, 445 F.2d 940 (2d Cir. 1971), *cert. denied* 404 U.S. 850 (1971), there was neither negligence nor fraud ("the chronology of events refutes any knowledge of, or suppression by, the New York prosecutor of the Florida indictment." (445 F.2d at 944)).

²⁷ The attempt in the Government's brief (at GB 30, fn.*) to distinguish the SEC functions relative to criminal cases from those of the IRS is, we respectfully submit, incorrect. Both the SEC and the IRS have investigative and enforcement powers, summons power, the power to seek judicial enforcement of summonses, and the statutory power to refer cases to the Justice Department.

(c) *The Alleged Limited Nature Of The SEC's Misconduct, And The SEC's Alleged Administrative Prevention Of A Repetition.*

The Government suggests that (1) the SEC's misconduct here was an isolated instance, and (2) "the SEC has begun its own investigation to determine whether internal sanctions should be imposed against the SEC representatives involved in this case." (GB 32,fn. *).

The answer to the first contention is that there is nothing in the record to support it. Any evidence in this connection would be within the Government's control. However, the *Rodman* case obviously indicates that this is not the first such instance of SEC misconduct, and the case at bar obviously shows that even the dismissal sanction in *Rodman* was insufficient to deter similar misconduct by the SEC or to induce the SEC to take adequate prophylactic steps to avoid a repetition of improper conduct by its representatives in dealing with targets of its investigations. Moreover, the implication from conflicting testimony given by SEC attorneys at the hearing in this case strongly suggests that no such steps have been taken. Stanley Sporkin testified that there is "a strict policy" within the SEC that the SEC will not negotiate a civil settlement based on an agreement that the SEC will make no criminal reference (Transcript 619-620), and the Associate Regional Administrator of the NYRO, Donald Malawsky, testified to the same effect (Transcript 1211). However, William Nortman, who at the time of the SEC's TDA investigation was Assistant Regional Administrator of the NYRO and at the time of the hearing was Associate Regional Administrator of the SEC's Atlanta Regional Office, testified that he understood that such negotiations at the staff level were appropriate and proper (Transcript 1765-1770).

The Government also states (at GB 32, fn. *) that the SEC has undertaken its own investigation of this case to determine what if any internal sanctions may be appropriate. The clear implication from this statement is that the Court in this case need not have exercised its supervisory powers, as the SEC has undertaken adequate internal steps to prevent recurrences of

misconduct (although even these alleged internal steps would provide no remedy to the appellees in this case). The record reference in support of this statement regarding the SEC's "own investigation" is an assertion contained in the prosecutor's affidavit in the District Court in support of the Government's motion for reconsideration of the District Court's decision. There, the Assistant United States Attorney stated that he had been authorized by Wallace Timmany, Assistant Director of the SEC's Division of Enforcement in Washington, D. C., to represent to the Court that "on the basis of the factual findings contained in the opinion of the Court, the Commission has undertaken an independent inquiry in this matter at the conclusion of which the Commission will take all actions which it deems appropriate." (A 128). Significantly, as of the time of the Government's filing of its appellate brief in this Court over three months after this representation was made, no results of this "internal investigation" were ever indicated to the Court. The reason for this now appears clear, and, although the events are too recent to have been made part of the record, we feel obligated to bring them to this Court's attention. In response to a request for the results of this investigation, which request was made under the Freedom of Information Act by counsel unconnected with this case and in another matter²⁸, the General Counsel of the SEC has responded:

"Although an initial decision had been made to conduct the inquiry to which you refer we subsequently informally decided to defer the inquiry until the *United States v. Fields* case is concluded. Therefore, as far as we can determine, the Commission staff has not prepared any documents on the matter."

SEC General Counsel's letter, and the correspondence to which it responds, are set forth at SA 1-SA 4.

²⁸ We have been advised by counsel to whom the SEC General Counsel's letter responds that the matter in connection with which SEC General Counsel's letter was written is related to an investigation by the SEC of Meridian Fast Food Services, a case referred to in Tucker's December 1, 1975 letter to Assistant United States Attorney Wing referring the TDA case. (A 205).

Thus, notwithstanding the Government's suggestion to the District Court, repeated to this Court, that the SEC is adequately pursuing the matter internally, and that the District Court's exercise of its supervisory power was therefore unnecessary, the SEC's investigation presently appears to be at a complete standstill—and has been at a standstill for a length of time known only to the Government.

Accordingly, it is respectfully submitted that dismissal by the District Court in the exercise of its supervisory power was especially appropriate not only to remedy the wrong perpetrated on appellees by the Government, but also to prevent future misconduct. See *United States v. Estepa*, 471 F. 2d 1132 (2d Cir. 1972); *United States v. Jacobs*, 531 F. 2d 87 (2d Cir. 1976), judgment vacated and case remanded for further consideration, U.S. , 97 S.Ct. 299 (1976), previous decision adhered to 547 F.2d 772 (2d Cir. 1976), cert. granted U.S. (May 31, 1977). It is respectfully submitted that any sanction or remedy other than dismissal by the District Court would have been, or by this Court would be, an indication to the SEC and to other administrative agencies that the type of misconduct engaged in by the SEC's attorneys in this case will not be forcefully and effectively dealt with by the courts, and that such would not serve as an effective prod toward good faith and honest dealings by the Government with the public.

(d) "Unclean Hands"

The Government asserts (at GB 32-33) that because the so-called "Zammas manipulation" was not among the alleged crimes disclosed to the SEC by Gould, the appellees' "unclean hands" bar them from obtaining equitable relief. However, it is respectfully submitted that the District Court's remedy amply considered and amply accommodated the principle of "unclean hands".

In the first place, the Government's use of the words "defendants" and "their wrongdoing" (GB 32—GB 33; emphasis added) is misleading. The Government conceded (at

the very end of the day of oral argument that followed the hearing) that the only defendant allegedly involved in the alleged "Zammas manipulation" was defendant Fields (SA 27-SA 28). Thus, at its best the Government's "unclean hands" argument would apply only to Fields.²⁹

Moreover, it is respectfully submitted that the allegations of the "Zammas manipulation", even if true, did not warrant

²⁹ The Government, perhaps on the theory that "bad cases make bad law", and as an improper means of attempting to generally blacken the appellees, half-heartedly attempts to justify the SEC's action in this case by stating that "the proof at trial will show that defendants have demonstrated a willingness to employ threats of violence to serve their criminal purposes." (GB 31, fn.) Significantly, there is no record reference for this allegation, only a reference to a "letter" sent by the Government to the District Judge. The Government made the same unsupported assertion in its post-hearing memorandum in the District Court, without having introduced any supporting evidence during the hearing, and the District Court, on motion of counsel for Fields and Friedman to strike that assertion, agreed and held that it was indeed "dehors the record" (SA 25). The Government did not contest that ruling, nor attempt to supplement the record in any respect. The Government, in again making this assertion in this Court, without the slightest bit of support in the record, well knows that it is completely unsupported, but apparently hopes this Court will be unable to "unring" a bell once heard. Simply put, this is clearly improper, and the Government knows so. Moreover, the unsupported allegation which the Government now makes in its appellate footnote was investigated by the New York County District Attorney's Office during the course of its overall investigation of TDA and Westcalind, and the District Attorney's Office concluded that there had been no offense cognizable under New York State law, as such a threat would plainly have been (SA 23-SA24). Nor was there any evidence or suggestion during the hearing that the SEC attorneys in pursuing their deceptive stratagem chose to do so to the slightest extent because of the allegation to which the Government's footnote now alludes. Indeed, the District Court found as a fact that in this case there were no circumstances warranting concealment of the fact of the criminal reference having been made (A 71). Even the prosecutor, in his final argument to the District Court, stated, "I certainly would not stand up here as a lawyer, a government lawyer and an officer of the court, and say that I think that is fine. Of course I would disapprove of that sort of thing. I do disapprove of it if that's what happened." (SA 26).

denial of the motion to dismiss as to Fields. All of the matters set forth in the indictment, including the alleged "Zammas manipulation", came to the attention of the United States Attorney's Office and the grand jury solely and directly as a result of the SEC's breach of its agreement not to make a criminal reference. The "Zammas manipulation" aspect in the indictment was no less a fruit of the SEC's violation of the agreement than were the other aspects of the indictment. The SEC's criminal reference of the case was in no respect caused or influenced by any aspect of the alleged manipulation. Appellees and their counsel were never advised that the SEC believed that the disclosures by Gould and Kantor on January 14, 1975 were in any respect incomplete or inaccurate on any grounds, including the alleged manipulation. Significantly, the SEC had the opportunity to, and did, thoroughly investigate the alleged "Zammas manipulation"; in the course of that investigation the SEC compiled a comprehensive file, although the SEC never brought these allegations to the attention of the appellees (including Fields) or their attorneys. After finishing its investigation of the allegations of the "Zammas manipulation", the SEC concluded that there was no satisfactory proof of any such manipulation. (Tucker advised both Gould and Kantor on June 17, 1975, that the SEC had virtually concluded its investigation, and that the initial disclosures had been substantially complete and accurate. (F 21)) Finally, and most importantly, the SEC's referral of the case for criminal prosecution, in violation of its understanding with the appellees and under circumstances of deceit, was not motivated to the slightest extent by the alleged "Zammas manipulation"; no witness testified that this alleged non-disclosure formed the slightest basis for the SEC's misconduct in this case, or was even considered as a factor, or, indeed, that the SEC ever considered it a non-disclosure or ever so advised appellees' counsel. (A 695-A 742)

For these reasons, the appellees—or, specifically, Fields—urged the District Court to dismiss the entire indictment, including the alleged "Zammas manipulation" as to Fields.³⁰

³⁰ In considering the Government's inaccurate claim that the appellees' counsel have "conceded" appellees' guilt—discussed *supra* p. 1, fn.—it is noteworthy that counsel for Fields and Friedman, in addressing this argument by the Government in the District Court, argued that the appellees did not in fact engage in the Zammas manipulation (SA 16—SA 17).

However, the District Court, because the alleged "Zammas manipulation" was not disclosed to the SEC, chose to leave the allegations of the "Zammas manipulation" intact. Thus, appellee Fields, rather than being permitted, as the Government claims (at GB 19-21), "totally to escape prosecution", is still exposed to trial on Counts 1, 2, and 3 of the indictment insofar as those counts contain allegations of the "Zammas manipulation"; if convicted, Fields is exposed to a maximum sentence on those counts of five years imprisonment plus a \$10,000.00 fine, five years imprisonment plus a \$5,000.00 fine, and five years imprisonment plus a \$10,000.00 fine, respectively.³¹ (If indeed there was an agreement, as previously set forth, these aspects of the indictment should also have been dismissed.)

POINT III

The District Court Properly Struck, on Alternative Grounds, Portions of the Indictment Relating to the ERD Transactions

It is respectfully submitted that it is unnecessary for this Court to consider the Government's appeal from the District Court's decision which granted the alternative motion made by appellees Fields and Friedman to strike allegations regarding the ERD transactions from Counts 1-3 and to dismiss Count 4, as the action of the District Court in dismissing those and other portions of the indictment was entirely proper for the reasons previously set forth in Point I and Point II.

However, in the event this Court considers it appropriate to examine this alternative aspect of the decision below, it is respectfully submitted that the District Court's actions in striking allegations regarding the ERD transactions from Counts 1-3 and dismissing Count 4 was proper and should be affirmed, for the reasons set forth herein and in Point IV, *infra*.

³¹ Similarly, appellee Berge is still exposed to trial on Count 12 of the indictment, and if convicted may be sentenced to five years imprisonment plus a \$10,000.00 fine.

In considering whether the District Court properly held that these aspects of the indictment failed to state an offense, the Government's pre-indictment procedural dilemma should be considered at the outset. The indictment in this case was filed on November 8, 1976 (F 1). The applicable statute of limitations is five years (18 U.S.C. § 3282). Accordingly, if any offense charged in the indictment occurred prior to November 8, 1971, its prosecution would be barred by the statute of limitations. In a prosecution for conspiracy under 18 U.S.C. § 371 (which is the alleged violation in Count 1), the Government is "required to show that one overt act in furtherance of the conspiracy occurred after [the cut-off date under the statute of limitations], in order to avoid being time-barred. See *Grunewald v. United States*, 353 U.S. 391, 396-397, 77 S.Ct. 963, 1 L.Ed. 2d 931 (1957); *United States v. Portner*, 462 F.2d 678, 681 (2 Cir.), cert. denied, 409 U.S. 983, 93 S.Ct. 319, 34 L.Ed2d 246 (1972)." *United States v. Brasco*, 516 F.2d 816, 818 (2d Cir. 1975), cert. denied 423 U.S. 860 (1975). With this frame of reference, the charges in Counts 1-4 should be recognized for what they really are, that is, a procedural gimmick by which the Government attempted to revive the ERD and the Westcalind transactions, for even if the allegations relating to those transactions were true, their prosecution was outlawed by limitations in March, April, and May, 1976, respectively, five years after those alleged events occurred (18 U.S.C. § 3282) and some six months before this indictment was filed. The Government has tried in this indictment to avoid the plain bar of the statute of limitations by charging that appellees Fields and Friedman not only allegedly engaged in these transactions in conspiracy in March, April, and May, 1971, but also engaged in these transactions with a view that they "would and did not disclose [them] in said prospectus" filed some seven months later on November 10, 1971, thus allegedly violating Section 17(a) of the Securities Act of 1933 (§ 77 q (a) of Title 15, U.S.C.).

The fact that the statute of limitations was about to expire on the ERD and Westcalind transactions was recognized by the

SEC when it referred the TDA case to the United States Attorney's Office in a letter dated December 1, 1975 (A 205). That letter, from Tucker to Assistant United States Attorney John Wing, stated, among other things, "as I mentioned, the TDA Industries case raises a possible statute of limitations problem." Yet the indictment was not filed until nearly a year later. Somehow because of the busy schedules of various Assistant United States Attorneys, the United States Attorney's Office overlooked the TDA matter after it had been referred (SA18-SA20). The result, we submit, was that the Government was placed in a position where it was confronted with the bar of the statute of limitations, and they attempted to claim that the ERD and the Westcalind transactions were the product of a conspiracy to violate Section 17(a) through the failure to disclose those transactions in the TDA prospectus filed on November 10, 1971 (which, if it were to constitute an offense, would fall within the statute of limitations by two days).

The prospectus, which was filed by TDA on November 10, 1971 in connection with a public offering of TDA stock, was improperly utilized by the Government, we submit, to attempt to resurrect under Section 17(a) time-barred charges. Section 17(a) prohibits specified schemes or frauds only if they are "in connection with the offer or sale of a security." The ERD and the Westcalind transactions, which are alleged to have occurred in March, April, and May, 1971 were far removed from any "connection with the offer or sale" of TDA securities reflected in the prospectus of November 10, 1971, and could not and did not sully the purity of those sales. *Smith v. Murchison*, 310 F.Supp. 1079, 1086 (S.D.N.Y. 1970); *Haberman v. Murchison*, 468 F.2d 1305 (2d Cir. 1972); *Barnett v. Anaconda Co.*, 238 F.Supp. 766, 770 (S.D.N.Y. 1965). Moreover, even assuming arguendo the allegations in the indictment, these transactions by themselves could not be and were not in violation of Section 17(a) because "that section only made it unlawful to defraud or deceive purchasers of securities." *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 463 (2d Cir. 1952), *cert. den.* 343 U.S. 956

(1952); *Continental Bank & Trust Company of Salt Lake City v. Garfinkle*, 292 F.Supp. 709, 711-712 (S.D.N.Y. 1968).

The charge with respect to the ERD transactions in Count 1 reflects that the purchaser, "Bernardi", was not deceived but rather did deceive ERD, the seller. This was equally true with regard to the Westcalind kickback, as Westcalind was alleged to have been a purchaser and not a seller of the security there involved (see SEC v. TDA, 75 Civ. 4519 (S.D. N.Y.), p. 14 of the civil complaint filed by the SEC in this matter). Moreover, neither of these transactions, it is submitted, could become violations of Section 17(a) through the guise of a claimed duty to disclose those transactions in the TDA prospectus since it is evident that these alleged events, having occurred some seven months prior to the transactions, were not "in connection with the offer or sale" of the TDA securities involved in the November 10, 1971 prospectus.

The problem which forced the Government to attempt to camouflage the charge by using the prospectus as a vehicle for the alleged fraud resulted in the following factors, all of which the District Court noted were determinative of its action in striking the ERD transactions from Counts 1-3:

(a) The indictment failed utterly to set forth any legal duty or obligation to disclose the ERD transactions in the November 10, 1971 prospectus, as they had been allegedly accomplished and completed some seven months earlier;

(b) The indictment failed utterly to set forth any allegation of fact as to what item or statement in the prospectus was rendered misleading as a result of the alleged omission of the ERD transactions;

(c) The indictment failed to allege in what way the ERD transactions operated as a fraud and deceit upon purchasers of TDA stock since it was evident from the charge that the ERD transactions, having occurred seven months earlier, could not and did not have any "con-

nection with" the offer to sell the TDA securities on November 10, 1971, as is required under Section 17(a), the object of the conspiracy in Count 1.

The Government did not address itself in the District Court to these contentions raised by appellees Fields and Friedman, but rather in a simple sentence contended that the "defendants conspired to defraud the public in connection with the sale of TDA common stock." (GB memorandum below, at p. 22). Accordingly, there was no allegation of a single fact, nor was there authority cited by the Government, to sustain the claim in Counts 1-3 that the omission of the ERD transactions from the prospectus was an omission of a material fact which violated Section 17(a) of the Securities Act of 1933 as charged.³² What was said by this Court in *Haberman v. Murchison*, *supra*, although related to a 14A proxy charge, is an appropriate answer to what the Government sought to accomplish with the charge in Count 1 as it related to the ERD transactions:

"Appellant's efforts to link the alleged failures to meet statutory disclosure requirements with the alleged plan of appellees to sell their shares at an illegal premium impress us as unavailing in either fact or law. The statutory causes of action sounding in the 1934 Act, which appellant has alleged, are tangential at best to his central concern, which is his assertion that in the summer and fall of 1962 appellees fell below the standard of fiduciary duty owed by them to Alleghany. That is a cause of action arising under state law, and no amount of forced employments and illogical invocations of the 1934 Act can make it otherwise." (468 F.2d at 1313-1314)

In addition to the District Court's determination that the Government was using a gimmick to attempt to resuscitate the outlawed ERD transactions through the totally unconnected

³² The Government, citing *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), argues (at GB 41) that under that decision the District Court should have at least left the issue to the jury, but here there was no issue of fact raised by the Government either in Count 1 or in its memorandum below to warrant submission of the issue to a jury.

means of the prospectus filed some seven months later, with all the problems that that presented, the District Court found nothing in the ERD transactions which rendered the items in the prospectus false or misleading. It is fundamental that to constitute an offense the claimed omissions from the prospectus must not only be material but must render the other statements made false and misleading. *Wessell v. Buhler*, 437 F.2d 279 (9th Cir. 1971); *Landy v. FDI Corp.*, 486 F.2d 139, 162 (3d Cir. 1973), *cert. den.* 416 U.S. 960 (1974); *Ash v. Brunswick Corp.*, 405 F. Supp. 234 (D. Del. 1975); *Parsons v. Hornblower & Weeks*, 1976-1977 CCH Fed. Sec. Rep. ¶95,885 (M.D.N.C. 1977).

The District Court referred to the lack of any claim in the indictment that the non-disclosure of the ERD transactions had any impact on the financial condition of TDA, "such that innocent purchasers were lured into investing in a corporation whose true condition had been materially misrepresented to them" (A 85). The District Court, it is respectfully submitted, applied the correct test of materiality insofar as it dealt with a claimed omission of a material statement in a prospectus. "The purpose of the registration statement and the prospectus is to prevent fraud by fully and fairly disclosing the nature and finances of the company to investors who contemplate investing in the company." *In Re Discon Corporation*, 346 F. Supp. 839, 844 (S.D. Fla. 1971).

As then District Judge Gurfein noted in *Wolfson v. Solomon*, 54 F.R.D. 584, 592 (S.D.N.Y. 1972):

"It is the market impact which arises from the non-disclosure that causes the injury, rather than the non-disclosure itself."

The Government made no attack on the District Court decision in this respect in its motion for reargument. Indeed, it now concedes (at GB 37) that it failed utterly in the District Court to indicate or show how the omission of the ERD transactions reflected upon TDA's true financial status. The

Government now seeks to excuse its failure by claiming that appellees Fields and Friedman did not advance the Court's "theory of materiality" (GB 37, fn.). In addition to the fact that this assertion scarcely provides the Government with a protective haven, the Government overlooks as well that appellees Fields and Friedman did argue in substance what the District Court found, i.e., that there was no causal connection whatever between the alleged fraud charge, that is, the omission of the ERD transactions, and the actual sale of the TDA securities on November 10, 1971 (see A 83-A 84).

Indeed, the Government's assertions, made for the first time in this Court, of totally different grounds upon which appellees Fields' and Friedman's motion should allegedly have been denied and why the District Court's decision was allegedly incorrect should not be allowed here in view of this Court's repeated holdings on the issue of waiver. See cases set forth *supra*, at pages 34-35.

But even considering the Government's present argument on the merits, the Government gains no ground by claiming that the District Court erred because "the Courts have found many material omissions which do not bear in any way upon the financial condition of the issuer" (GB 39, citing three cases). Even if this were true, the Government still has failed to demonstrate that the indictment alleged a single fact on which the District Court could rely to sustain the claim that the omission of the ERD transactions was a material omission from the prospectus. Moreover, none of the cases cited by the Government is even remotely applicable to this case, nor does any stand for the summary statement set forth by the Government with respect to each of the three cases. Thus, for example, *SEC v. Parklane Hosiery Co., Inc.*, CCH Fed. Sec. Rep. ¶ 96,108 (2d Cir. 1977), not only involved a failure of a majority shareholder to disclose his reasons for going private, but the proxy statement also failed to disclose a possible lease cancellation which had a substantial impact on the earnings of Parklane and was thus material to the issue to be voted on for

which the proxy was solicited, and, further, the purchasers of the stock were not advised in the proxy statement of the plans of management in connection with the merger, which was a material omission since it affected the stockholders' choice as to whether "to opt for appraisal proceedings or to accept Parklane's offer . . ." *SEC v. Parklane Hosiery Co.*, *supra*, at p. 91,996. Obviously, these nondisclosures related principally to the matters upon which authorization was sought from the proxy vote solicited. This, we submit, is the test of materiality which the District Court correctly applied in finding that the alleged omission of the ERD transactions "did not in any discernible way bear upon the financial condition of the company whose shares were being publicly marketed." (A 84-A86).

SEC v. Rapp, 304 F. 2d 786 (2d Cir. 1962), also cited by the Government, involved an action for an injunction to restrain the selling of corporate stock in violation of Section 17(a). This Court noted that the conduct alleged gave a false picture of the true financial condition of the corporation and it "conveyed an admittedly false picture of financial and physical reserves." (304 F.2d at 791) While it is true that this Court also said that the defendant Rapp misled customers into thinking he was an agent rather than a principal, this fact was clearly not the only or principal reason for this Court's decision. To the contrary, a material fact stressed in this Court's decision was the impact on the investing public caused by the concealment of the true financial condition of the company, a fact significantly absent from the charge in the instant case, as properly noted by the District Court.

SEC v. Falstaff Brewing Corp., CCH Fed. Sec. Rep. ¶ 96,117 (D.C.D.C. 1977) likewise was not merely a "failure to disclose enhancement of control that would result from a proposed stock dividend", as claimed by the Government, nor was it a case pertinent to the instant matter except as it may relate to our later discussion relating to the District Court's dismissal of Count 4 (*infra*, Point IV). The District Court in

Falstaff Brewing noted that the 1975 proxy statement solicited proxies seeking authorization and approval to sell preferred stock to one K and to authorize the issuance of said preferred stock. The proxy statement failed to disclose that approval by the stockholders would give K 52% of the voting stock and that K would control the board of directors. These were held to be material facts since they related to the very transactions for which approval was sought from the stockholders.

None of these cases casts the slightest blemish on the correctness of the District Court's conclusion that the ERD transactions were not material facts necessary to be disclosed in the TDA prospectus of November 10, 1971, where those transactions as charged in Counts 1-3, as the Court properly noted, had no impact on the financial condition of TDA "relevant to a purchaser's informed decision on the merits of investing in the company." (A 86).

The Government, however, advances the claim (for the first time in this Court) that any potential investor would find it "material" to know that "other investors in TDA had been cheated out of \$435,000 by the company's president and financial vice-president . . . because the \$435,000 profit obtained . . . was in effect an uncollected asset of TDA, since it resulted from 'short swing' trades 'recoverable by the issuer' ", pursuant to Section 16(b), which conversion "dramatically depleted TDA's corporate treasury." (GB 39-40).

Putting to one side the Government's waiver of this argument by its failure to advance it below, there is also substantial doubt that the ERD transactions constituted a sale or purchase by appellees Fields and Friedman or that they were beneficial owners within the meaning of Section 16(b). See, for example, *Whiting v. Dow Chemical Co.*, 523 F.2d 680, 686 (2d Cir. 1975), where this Court noted:

"In a traditional sense, in the absence of a statutory definition, a beneficial owner would be a person who does not have the legal title to the securities but who is, nevertheless, the beneficiary of a trust or joint venture, or is a shareholder in a corporation which owns the shares."

It is respectfully submitted that appellees Fields and Friedman were not beneficial owners of the stock sold by ERD to Bernardi. Without a specific definition of what constitutes "beneficial owner", this Court noted in *Whiting* that "the warning [of 16(b)] may sometimes be inadequate for the automatic liability imposed." (523 F.2d at 687). We submit that the ERD transactions did not, as claimed by the Government, "involve . . . short swing trades by [appellees Fields and Friedman]" (GB 40). As charged in Count 1, the sales and purchases were between "ERD" and "Bernardi", not between ERD and appellees Fields and Friedman. Appellees Fields and Friedman never had title or ownership of the stock at any time. It is true that appellees Fields and Friedman were alleged to have had a financial interest in the transactions as charged in Count 1, but there is nothing in Section 16(b) to indicate that merely having such an interest without ownership or title to the TDA stock resulted in a short swing trade within 16(b).

In addition, the transactions themselves were totally unrelated to the purpose for which Congress enacted Section 16(b), which was,

"for the purpose of preventing the unfair use of information which may have been obtained by [a statutory insider] . . . by reason of his relationship to the issuer. Congress recognized that short-swing speculation by stockholders with advance, inside information would threaten the goal of the Securities Exchange Act to 'insure the maintenance of fair and honest markets'. Insiders could exploit information not generally available to others to secure quick profits." *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U. S. 582, 591-592 (1973).

The alleged ERD transactions as charged in Count 1 did not involve any such use of inside information by appellees Fields and Friedman and thus did not fall within the Congressional purpose for which Section 16(b) was enacted. Since the statute requires the insider to disgorge all profits realized on all purchases and sales within six months without proof of intent to

profit or proof of actual abuse of inside information, "the prevailing view is to apply the statute only when its application would serve its goals." *Kern v. Occidental*, *supra* at 595.

It should also be noted that the profit alleged to have been received by appellees Fields and Friedman was not \$435,000, as now asserted by the Government (GB 39-40), but rather, as alleged in Count 1, the sum of "more than \$25,000" paid "during the period of April 19, 1971 to November 10, 1971" (Count 1, ¶ 10(h)). Moreover, as the District Court found, "the SEC's own investigation revealed that the total amount received by [appellees Fields, Friedman and Davis] from the ERD transactions was actually \$72,250.00", not \$435,000³³ (A 117). It is only the net profit actually received on a short swing trade that can be recovered under Section 16(b), and not the gross amount of the transaction, as indicated by this Court in *Adler v. Klowans*, 267 F.2d 840, 849 (2d Cir. 1959).

The Government contends that these profits should have been disclosed in the TDA prospectus filed on November 10, 1971 but, as noted above, Count 1 of the indictment fails utterly to indicate how much-if any-of the profit was received by June 30, 1971, the end of the TDA fiscal year selected for the balance sheet figures contained in that prospectus. The "more than \$25,000.00" figure is alleged in Count 1, paragraph 10(h), to have been received sometime "during the period April 19, 1971 to November 10, 1971". As noted previously, the SEC civil complaint alleges that the defendants received \$72,250.00 sometime between June 3, 1971 and February 13, 1973. Obviously, not even the Government claims that there should have been disclosure in the prospectus of November 10, 1971 if the cash or any part thereof was received after the June 30, 1971 TDA fiscal period, the date reflected on the balance sheet

³³ The SEC in its civil complaint filed in the United States District Court for the Southern District of New York, 75 Civ. 4519 (LWP), in paragraph 41(f), also stated that "the defendants Fields, Friedman and Davis received in cash [on the ERD transactions] during the period from June 3, 1971 to February 13, 1973 the sum of \$72,250", not \$435,000. See also p. 28, *supra*.

figures. Thus, even if the Government's belated claim that the ERD transactions resulted in short swing profits were to be accepted, nothing in Count 1 charged that the profits were received during a time with respect to which disclosure was required in the prospectus, or that appellees Fields and Friedman were required to disclose the transactions in the prospectus of November 10, 1971. This Court's statement in *SEC v. Texas Gulf Sulphur*, 401 F.2d 833, 850 (2d Cir. 1968), *cert. den.* 394 U.S. 976, that an insider's trades do not have to be disclosed immediately renders even more questionable the Government's position that the ERD transactions should have been disclosed in the prospectus. In *Texas Gulf Sulphur*, this Court said:

"We do not suggest that material facts must be disclosed immediately; the timing of disclosure is a matter for the business judgment of the corporate officers entrusted with the management of the corporation within the affirmative disclosure requirements promulgated by the exchanges and by the SEC." 401 F.2d at 850, n.12.

In addition, the amount of "more than \$25,000.00" which Count 1 says appellees Fields, Friedman and Davis received on the ERD transactions should be compared with the total assets reflected in the financial statements of TDA and its wholly owned subsidiaries contained in the prospectus. The combined assets amounted to \$18,681,657. Even if we were to assume that appellees Fields, Friedman and Davis received \$72,250.00 (which the SEC in its Civil complaint alleges was received sometime between June, 1971 and February, 1973), either \$25,000.00 or \$72,250.00 were minor amounts compared not only to the TDA assets as of June 30, 1971, but also in relation to TDA's assets reflected in its annual statement as of June 30, 1973, which totaled the sum of \$29,186,490.00, an increase of over \$10,000,000.00 at a time the Government's brief states the ERD transactions "dramatically depleted TDA's corporate treasury"³⁴ (GB 40). Under no stretch of the imagination can

³⁴ It is difficult to understand how the Government can maintain on the one hand that the District Court was in error in concluding "that defendants' ill-gotten gains had not been at the expense of TDA, and therefore was not relevant to a purchaser's informed

it be said that such minor amounts, even if they were uncollected assets of TDA, were omissions sufficiently material to have affected the financial condition of TDA as reflected in the prospectus so as to deter the average prudent investor from purchasing the securities in question. The average prudent investor is not concerned with minor inaccuracies. What would deter such an individual from purchasing a security are facts which would have an important bearing on the nature or condition of the issuing corporation or its business. In this respect the test applied and conclusion reached by the District Court were eminently correct and should be affirmed by this Court.

The Government in conclusion on this point argues that "When key corporate officers demonstrate a willingness to cheat the corporation's own shareholders and a complete disregard of the securities laws, . . . investors must consider that the company's officers may have committed other, as yet undiscovered, violations and that they may have a propensity to commit similar violations in the future." (GB 40-41). However, after an extensive hearing below wherein all aspects were aired relating to the knowledge by the SEC of the ERD transactions and the Westcalind kickback, as well as the other charges in the indictment, it is difficult to understand how the Government can make this statement about appellees Fields and Friedman in view of the fact that the SEC permitted both of them, in the settlement of the civil suit, to remain as officers of TDA and Westcalind (A117-A118, n. 2(e), where the Court stated: "However, Fields was permitted to remain president, in which capacity he would be chief operating officer, and Friedman was permitted to retain his position as well"). This action of the SEC, we submit, is a complete refutation of the Government's argument in this respect, and inferentially supports the

decision on the merits of investing in the company" (GB 40, fn. *), and on the other hand suggests to the Court as an equitable remedy that rather than strike the ERD transactions and dismiss counts of the indictment, as it did, appellees Fields, Friedman and Davis should be permitted to retain those alleged ill-gotten gains for themselves.

District Court's opinion as to the immateriality of the disclosure of the ERD transactions in the prospectus and the complete justification for the striking of those transactions from Counts 1, 2 and 3.

POINT IV

The District Court Properly Dismissed Count 4 on Alternative Grounds

We respectfully submit that the District Court was also correct in dismissing Count 4, and that its action in doing so is amply supported by substantial authority.

Count 4 charged that appellees Fields, Friedman and Davis violated Section 14(a) (15 U.S.C. § 78n(a)) on December 17, 1971 by soliciting proxies from TDA stockholders containing statements which were rendered false and misleading for failure to disclose the transactions set forth in Count 1, which Count 4 incorporated by reference. Appellees contended in the District Court that Count 4 was defective in that it failed to allege any of the matters contained in the proxy statement which were allegedly rendered false and misleading, and, further, that Count 4 failed to indicate any causal connection between the fraud alleged and the alleged falsity of the proxy statements. The District Court refused to dismiss Count 4 on the first ground, but did so on appellees' second ground, holding that Count 4 was defective for failing to allege any causal connection between the alleged fraud and the matters on which the proxy solicitation was sought. The District Court on its own examined the proxy material because "if it is apparent that at the conclusion of the Government's case the defendants would be entitled to dismissal of these counts as a matter of law, the nettle might as well be grasped at this time." (A 89). The District Court concluded that:

"Count 4 must be dismissed because there is no causal connection between either of the acts scheduled for the TDA stockholders' meeting (amendment of the stock

option plan and election of directors) and the various acts and transactions alleged in count 1 of the indictment." (A 90)

The District Court did not rely solely on two decisions by Judge Owen in *SEC v. Kalvex, Inc.* 425 F. Supp. 310 (S.D.N.Y. 1975) and *Levy v. Johnson*, 1976-1977 CCH Fed. Sec. L. Rep. ¶95, 899 (S.D.N.Y. Feb. 15, 1977), as claimed by the Government (GB 43), in arriving at its decision to dismiss Count 4; but in fact extensively reviewed decisions of this Court and decisions of other courts, including the Supreme Court of the United States. The cases are set forth in the Court's opinion (A 90-92). The District Court cited *Schlick v. Penn-Dixie Cement Corp.*, 507 F. 2d 374, 383 (2d Cir. 1974), *cert. den.* 421 U.S. 976 (1975), wherein this Court quoted with approval the following statement from *Weiss v. Sunasco, Inc.*, 316 F. Supp. 1197, 1205 (E. D. Pa. 1970):

"... the proper test is whether the proxy solicitation is an essential link in the accomplishment of the transaction giving rise to the litigation, irrespective of the fact that other possibilities were available to management."

This requirement of causal connection, the District Court noted, reflects the purpose of Section 14(a), as described by the Supreme Court in *J. I. Case Co. v. Borak*, 377 U. S. 426, 431 (1964):

"The purpose of § 14(a) is to prevent management or others from *obtaining authorization for corporate action* by means of deceptive or inadequate disclosure in proxy solicitation." (emphasis added)

The District Court properly concluded that the alleged illegal acts charged in Count 1 and incorporated by reference in Count 4 "had been accomplished prior to the stockholders' meeting referred to in the TDA proxy solicitation, [and did not bear] any direct relationship to the business sought to be accomplished at the meeting, and referred to in the proxy statement." (A 91-92). In other words, appellees Fields and

Friedman as "management" did not seek to obtain any authorization from the stockholders for the accomplishment of the acts complained of "by means of deceptive or inadequate disclosure", *J. I. Case Co. v. Borak*, *supra*, and further, the proxy solicitation was not an essential link in the accomplishment of those transactions and the acts charged therefore did not constitute a violation of Section 14(a).

The District Court rejected the further contention of the Government that the alleged conduct should have been disclosed in the proxy solicitation, at least with respect to the nomination of appellee Friedman for election as a director, citing Judge Owen's decision in *Levy v. Johnson*, *supra*. In an identical situation, Judge Owen there rejected the same argument, holding:

"In the instant case, the only corporate action sought to be authorized by the proxy solicitation in question was the directorial elections of 1970 through 1975. The alleged improper payments were not the subject of the proxy solicitation. If at all, they represent a breach of defendant directors fiduciary duty to their corporation. Lacking, therefore, is the 'transaction causation' component of a section 14(a) claim that is required by the Second Circuit. *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 381-83 (2d Cir. 1974); *Walner v. Friedman*, 410 F. Supp. 29, 32 (S.D.N.Y. 1975)."

The Government moved to reargue the dismissal of Count 4 by referring to the TDA annual report for the fiscal year ending June 30, 1972, which it contended reflected a "relationship of the activities of Westcalind to the financial condition of TDA", in the light of which the Government argued that "the 'Westcalind kickback' constituted a direct depredation of corporate assets by a director" (A 128-A 129). In adhering to its original decision, the District Court noted that neither the assets of Westcalind nor its income or profits were included or required to be included in TDA's financial statements. Indeed, it appeared that such consolidation would have been improper under SEC rules, where, as here, TDA was not a majority

shareholder of Westcalind. (SEC Reg. S-X, Article 4, 17 CFR § 210). TDA owned only 34% of Westcalind stock as of fiscal year ending June 30, 1972. The indirect impact of the Westcalind kickback on TDA's investment in Westcalind stock was held by the District Court to be too remote and speculative to constitute the transaction causation necessary for a violation of Section 14(a). Accordingly, the Court adhered to its original decision, citing in addition to *Levy v. Johnson*, Judge Pierce's decision to the same effect in *Lewis v. Elam*, CCH Fed. Sec. Rep. ¶ 96,013 (S.D.N.Y. 1977). Substantial additional authority, we submit, may be found in *Limmer v. General Telephone & Electronics Corp.*, CCH Fed. Sec. Rep. ¶ 96,111 (S.D.N.Y. 1977), in an opinion by District Judge Connor at page 92,002; *Walner v. Friedman*, 410 F. Supp. 29, 32 (S.D.N.Y. 1975); *Robbins v. Banner Industries, Inc.*, 285 F. Supp. 758, 762-763 (S.D.N.Y. 1966); *Epic Enterprises, Inc. v. Brothers*, 395 F. Supp. 773, 776 (N.D. Okla. 1975).

The Government further argues that the District Court failed to consider "Federal Proxy Rules" which it claims "requir[ed] disclosure of the ERD and Westcalind kickbacks in the TDA proxy." (GB 44). Yet the Government fails to state that no such proxy rules were mentioned by the Government to the District Court. For the first time in this Court, the Government asserts that the Proxy Rules "supply the element of 'transaction causation', i.e., the transaction caused is the election of corrupt directors." (GB 44).

The Government criticizes the District Court for failing to recognize that the distinction between Judge Owen's decision in *SEC v. Kalvex*, *supra*, and Judge Owen's decision in *Levy v. Johnson*, *supra*, was that in *SEC v. Kalvex*, *supra*, Judge Owen found a specific violation of SEC Proxy Rule, Item 7 of Schedule 14A, whereas in *Levy v. Johnson*, *supra*, "the improper foreign payments were not required to be disclosed by any provision of the Proxy Rules." (GB 44). It is anomalous, to say the least, that the Government criticizes the District Court for failing to make this claimed distinction when the Government

itself failed to suggest any such distinction in the District Court. The Government attempts to support this interpretation of Judge Owen's decision in *Levy v. Johnson, supra*, by suggesting that no such SEC Proxy Rule or requirement existed before and that the SEC has "recently moved to amend the Proxy Rules to require disclosure of improper payments to foreign or domestic officials," citing SEC Release No. 34-13185 issued January 19, 1977. (GB 44, fn.**). The Government, however, fails to disclose that in that very release the SEC specifically noted that its proposals "in large measure codify existing law rather than create new obligations," and further that "disclosure of the items proposed to be included expressly in Schedule 14A [the involvement of any officer or director in such questionable or illegal corporate payments and practices] would, if material, be required under existing law." Thus, the existence or non-existence of any Proxy Rule requiring disclosure does not support the Government's proposed distinction between *SEC v. Kalvex, supra*, and *Levy v. Johnson, supra*, on which its argument is based.

This is abundantly clear from *Epic Enterprises v. Brothers, supra*, where the District Court dismissed a Section 14(a) claim alleging that the proxy which sought the reelection by management of the defendant Holbrook as a director contained false and misleading omissions in violation of Section 14(a) in failing to disclose that management had approved an illegal and unauthorized loan to defendant Holbrook. The District Court appropriately stated:

"Assuming, arguendo, that the proxy solicitation did contain a material violation of § 14(a), it is apparent that Plaintiff has failed to state a cause of action upon which relief can be granted for the facts as plead[ed] do not show causation between the alleged false and misleading proxy statement and the alleged transactions causing the harm of which Plaintiff complains. The proxy solicitation was not a link in the accomplishment of either the (1) alleged overexpenditures or (2) the alleged illegal loan. These actions were taken by virtue of the Defendants'

position in the corporation and not through an authorization obtained through alleged false proxy statements." (395 F. Supp. at 776).

See also *Robbins v. Banner Industries*, *supra* at 762.

Equally unpersuasive is the attempt by the Government to distinguish cases which the Government concedes have held that "non-disclosure of a would-be director's prior misdeeds has been held not to constitute a violation," but in which cases the Government contends there existed no "specific" proxy rule requiring such disclosure (4, fn. *).

In three of the cases cited the Government seeks to distinguish on this ground—*Limmer v. General Telephone & Electronics Corp.*, *supra*, *Lewis v. Elam*, *supra*, and *Levy v. Johnson*, *supra*, all of which involved a claim of a failure to disclose in proxy solicitation for the election of directors that the particular director had been involved in illegal payments—the SEC Release No. 34-13185 issued on January 19, 1977, previously quoted, states that existing Proxy Rules issued by the SEC require such disclosure in a proxy solicitation. In *Epic Enterprises v. Brothers*, *supra*, one of the alleged violations claimed was the failure to disclose in the proxy for the election of a director that management had approved an illegal or unauthorized loan to that director. The District Court held this was not a violation of Section 14(a) despite the fact that Item 7(e) of Schedule 14A requires disclosure in a proxy statement of each nominee for election as a director "who was indebted to the issuer or its subsidiary at any time since the beginning of the last fiscal year of the issuer."

Thus, even if the alleged ERD transactions gave rise to "swing profits" which were required to be disclosed, as is provided in item 7(e)(4) of Schedule 14A, there would be no violation of Section 14(a) if in fact "the proxy solicitation was not a link in the accomplishment of the alleged improper [conduct complained of]." *Epic Enterprises v. Brothers*; *Levy v. Johnson*; *Lewis v. Elam*; *Robbins v. Banner Industries*; *Walner v. Friedman*.

This is equally true with respect to the Westcalind kickback insofar as it applied to the TDA proxy referred to in Count 4, for the reasons previously noted. Moreover, Westcalind was not a "subsidiary" of TDA, as the Government mistakenly characterizes Westcalind without a single shred of proof; TDA only had an investment in Westcalind of approximately 34% as of the fiscal year ending June 30, 1972, and Westcalind was not a subsidiary of TDA but merely an unconsolidated affiliated company (A 121-A 124).

Despite that fact, the Government repeatedly refers to Westcalind as "a TDA subsidiary" (GB 46—mentioned twice), and TDA as "the controlling shareholder in Westcalind" (GB 47). The annual statement of TDA for the fiscal year ending June 30, 1971, the prospectus of November 10, 1971, and the annual report to TDA shareholders for the fiscal year ending June 30, 1972 indicate, to the contrary, that neither Westcalind's assets nor its income or profits were included as part of the financial statement of "TDA and its subsidiaries". In no way, therefore, would Proxy Rule 7(f) of Schedule 14A, referring to a subsidiary of an issuer, have any relevance to the Westcalind kickback, as incorrectly urged by the Government.³⁵

The Government finds it difficult to understand how the Court could deny appellees' motion to strike the Westcalind transaction in Count 1 and yet grant the motion to dismiss Count 4 insofar as Count 4 charged in part the omission to disclose the Westcalind kickback in the proxy statement (GB

³⁵ The inapplicability of that Proxy Rule is evident from the proposed amendment to Item 7(a) set forth in the SEC Release No. 5758 issued on November 2, 1976. That release states:

"Item 7(a), for example, presently requires such statements [information about management remuneration] to disclose 'all direct remuneration paid by the issuer and its subsidiaries during the issuer's last fiscal year' to each director and the three highest paid officers . . . As discussed more fully above, a proposed amendment to Item 7(a), if adopted, would require disclosure of all such remuneration paid by the issuer and its 'affiliates.'" CCH Fed.Sec. L.Rep. ¶ 80, 783 at p. 87035.

47). No inconsistency exists in view of the different charges involved in Counts 1-3 and Count 4. Implicit in the District Court's opinion in refusing to strike the Westcalind kickback in Counts 1-3 was its realization that the transaction could have significance to a potential investor in view of the impact the transaction could have had on the TDA financial statements since TDA had an equity investment in Westcalind. The District Court had no such concern with the same transaction under Count 4 because, even assuming it was a material fact, its omission was not a violation of Section 14(a) since the alleged proxy violation "was not a link in the accomplishment of the alleged improper [kickback]."

POINT V

Adoption of Co-Appellees' Briefs

Appellees Fields and Friedman respectfully adopt all arguments contained in the briefs of their co-appellees to the extent applicable to them.

CONCLUSION

For the above reasons, it is respectfully submitted that the orders of the District Court should be affirmed.

Respectfully submitted,

BENDER & FRANKEL
Attorneys for Appellees
Fields and Friedman

LOUIS BENDER
SANDOR FRANKEL
Of Counsel

COPY RECEIVED
ROBERT B. FISKE JR.
OCT 23 1977
U. S. ATTORNEY
SO. DIST. OF N. Y.